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**MORALE, WELFARE AND RECREATION
AND COMMISSARY ISSUES**

HEARINGS

BEFORE THE

SPECIAL OVERSIGHT PANEL ON MORALE, WELFARE
AND RECREATION

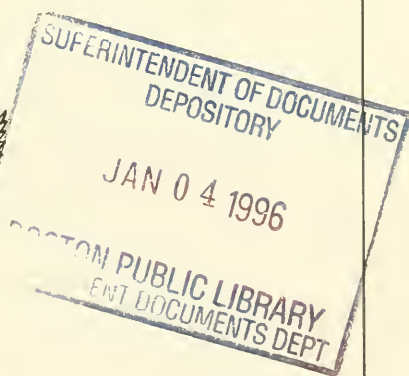
OF THE

COMMITTEE ON NATIONAL SECURITY
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

HEARINGS HELD
MARCH 29 AND APRIL 6, 1995



U.S. GOVERNMENT PRINTING OFFICE
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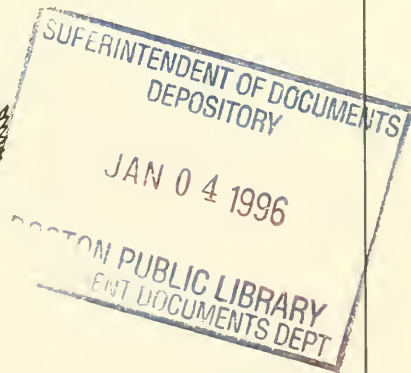
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SPECIAL OVERSIGHT PANEL ON MORALE, WELFARE AND RECREATION

JOHN M. McHUGH, New York, *Chairman*

SAXBY CHAMBLISS, Georgia

GLEN BROWDER, Alabama

BOB STUMP, Arizona

NORMAN SISISKY, Virginia

HERBERT H. BATEMAN, Virginia

SOLOMON P. ORTIZ, Texas

J.C. WATTS, JR., Oklahoma

OWEN PICKETT, Virginia

JOE SCARBOROUGH, Florida

JOHN TANNER, Tennessee

WALTER B. JONES, JR., North Carolina

ROBERT A. UNDERWOOD, Guam

(Vacancy)

JEFFREY M. SCHWARTZ, *Professional Staff Member*

STEPHEN O. ROSSETTI, Jr., *Professional Staff Member*

PEGGY COSSEBOOM, *Staff Assistant*

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THE EFFECT OF FORCE STRUCTURE DRAWDOWN ON MORALE, WELFARE AND RECREATION PROGRAMS

HOUSE OF REPRESENTATIVES,
COMMITTEE ON NATIONAL SECURITY,
SPECIAL OVERSIGHT PANEL ON
MORALE, WELFARE AND RECREATION,
Washington, DC, Wednesday, March 29, 1995.

The Panel met, pursuant to notice, at 2:04 p.m., in room 2212, Rayburn House Office Building, Hon. John M. McHugh, (chairman of the panel) presiding.

OPENING STATEMENT OF HON. JOHN MCHUGH, A REPRESENTATIVE FROM NEW YORK, CHAIRMAN, SPECIAL OVERSIGHT PANEL ON MORALE, WELFARE AND RECREATION

Mr. MCHUGH. Good afternoon. This meeting is called to order. Today, the Panel on Morale, Welfare and Recreation holds its first of two hearings as part of the deliberations on the fiscal year 1996 defense authorization bill.

Over the past several years, U.S. forces have been called upon to do more with less and less. These forces have answered the call repeatedly. As a result, this Nation, this Congress, and ultimately this Panel must respond in kind to provide a quality of life for our men and women in uniform which recognizes their dedication and sacrifice. The key to this is a strong morale, welfare and recreation program.

House National Security Committee Chairman Floyd Spence, in establishing the MWR Panel this year for the first time as a full committee Panel, highlighted the priority he places on these important issues. And having been bestowed with the honor of serving as chairman of this Panel, I share his commitment and I know I speak for all the other members of the Panel as well. We plan on taking an active, hands-on approach in dealing with the varied programs which comprise MWR.

Today's hearing will examine the fiscal year 1996 budget request, focusing on the effects of the defense drawdown on the morale and welfare of our military personnel and the extent to which MWR programs serve to mitigate the adverse affects of the stresses associated with that drawdown.

As chairman, I see this Panel as having two primary priorities. First of all, to protect the MWR benefit for our soldiers, sailors, airmen, and marines, and their families. We can do no less. In order to do this, we must set our second priority in the recognition that business as usual will no longer suffice. We must provide these MWR benefits in the most cost effective and efficient manner, by taking a new look at how these programs are delivered, reducing

overhead costs, and reassessing how best to ensure that we get the most mileage out of the resources—both appropriated and nonappropriated—provided for these programs. Fiscal reality demands we do no less.

Today we are honored to have with us a distinguished panel including Fred Pang, Assistant Secretary for Force Management at the Department of Defense; Brig. Gen. John G. Meyer, commander, Army Community and Family Support Center of the U.S. Army; Rear Adm. Larry R. Marsh, assistant chief of Navy personnel; Col. Steven B. Richards, director of the Directorate of Services of the U.S. Air Force; Brig. Gen. James R. Joy, U.S. Marine Corps (retired), director of MWR Support Activity, Headquarters of the U.S. Marine Corps. We welcome all of you here this afternoon, and we look forward to your testimony.

Before we begin, let me first call on my friend the gentleman from Alabama, Mr. Glen Browder, who serves as the Panel's ranking member, for any comments he may wish to make.

STATEMENT OF HON. GLEN BROWDER, A REPRESENTATIVE FROM ALABAMA, RANKING MINORITY MEMBER, SPECIAL OVERSIGHT PANEL ON MORALE, WELFARE AND RECREATION

Mr. BROWDER. Thank you, Mr. Chairman. I would like to make a few remarks—not just to be repetitious, but to emphasize the points that you made and the new way of approaching our business this year.

I congratulate you on holding these hearings. These programs are critical to the well-being of the force, and we need to hear from our distinguished panel of witnesses about some of the challenges that they face.

This Panel has always stood by our military people. Its reputation for caring and oversight is well known, and we will continue this tradition in the 104th Congress.

This is a new day. My colleagues and I have labored long and hard since this Congress convened, making hard choices on a number of issues that affect the entire Nation. It is in this context that the MWR issues will be addressed. Throughout the Federal Government we are seeing entire programs, and even agencies, being eliminated or proposed for elimination. Every budget item is being placed under the microscope. It is imperative that we maximize the effectiveness of taxpayer dollars. It is equally imperative that we maximize the revenue-generating capability of these programs.

Force structure reductions reduce the ability of the system to generate economies-of-scale in order to keep profit levels at the required rate and reduce the reliance on taxpayer support. Therefore, we must be aggressive in seeking ways to reduce overhead to ensure that benefits do not suffer.

As the budget tightens, the distinction between nonappropriated and appropriated funds diminishes. There is an increasing recognition of the ability of nonappropriated funds to provide an offset to funds that Congress cannot, or will not, appropriate for this purpose. The taxpayer and the military people demand that we undertake a new direction in the management of these programs and change the way we do business.

I hope the testimony we receive today will reflect this forward thinking and innovation.

Thank you, Mr. Chairman.

Mr. MCHUGH. We thank the gentleman for his remarks. We are also joined today on my right (your left) by the gentleman from Georgia, Mr. Saxby Chambliss, who also serves as vice chairman of the Panel. Mr. Chambliss, welcome. Do you wish to make any remarks?

Mr. CHAMBLISS. Thank you, sir. It is a pleasure to serve on this distinguished Panel with you and the other members who are here with us today, and those who are not. This is an issue that I consider very serious with our military because it is certainly an issue that makes living as a part of the military much more pleasurable, and that is something we have got to strive to make better. I look forward to hearing the testimony of these gentlemen today.

Mr. MCHUGH. Thank the gentleman. Also to my left (your right) are two gentlemen who are certainly no strangers to this Panel or probably to most of the people in this audience who have followed these issues. First of all, the gentleman from Virginia, Mr. Sisisky.

Mr. SISISKY. Thank you, Mr. Chairman. I have no comment. I yield to my colleague from Texas.

Mr. MCHUGH. The former Chairman of the Panel, Mr. Ortiz.

Mr. ORTIZ. I am happy to continue to be a member of this Panel, and I would like to say that I have worked with you in the past and you have all worked hard. We will try to come up with some answers to some of the questions that you might have as far as funding on some of these projects that are so important if we are going to continue to retain good men and women in the military. I am just happy to see this excellent group of witnesses here this afternoon.

Thank you, Mr. Chairman.

Mr. MCHUGH. Thank you. With that, I will turn the microphone and the attention of the Panel over to Secretary Pang for any comments he may wish to make. Welcome, sir. Please proceed as you desire.

STATEMENT OF FRED PANG, ASSISTANT SECRETARY FOR FORCE MANAGEMENT, DEPARTMENT OF DEFENSE

Mr. PANG. Thank you, Mr. Chairman, Mr. Browder, and members of the Panel. I welcome the opportunity to join my colleagues from the military services to discuss with you today the morale, welfare and recreation programs of the Department of Defense. A written statement which I have submitted for the record covers three areas. First, force management including the drawdown and stabilization of our forces. Second, the Department's morale, welfare and recreation programs. And third, Secretary Perry's broader quality of life initiatives.

I will focus my oral remarks on our morale, welfare and recreation programs, but before doing so I want to touch briefly on our management of the drawdown and our quality of life initiatives.

With regard to our management of the drawdown. I believe there is consensus that the right-sizing and restructuring of our forces following the cold war is not only prudent but necessary. I am pleased to report that its execution has been extraordinarily suc-

cessful because the Congress, the uniformed military leadership, and two administrations worked together to make it so.

The downsizing task was enormous. Our active duty military forces have been reduced by 24 percent since 1987; from 2.1 million to 1.6 million today. This is 80 percent of the way toward our goal of a force of 1.45 million. By the end of fiscal year 1996, the right-sizing of the active force will be essentially complete.

By skillfully managing the drawdown we have preserved a ready force. The quality and experience level of our forces are up, and we have the right mix of skills to accomplish our missions. The bottom line is that today we have a high quality, highly motivated force able to meet any challenge.

With regard to quality of life, Secretary Perry has embarked on an ambitious program focused on improving compensation, housing, and community support for our men and women in uniform and their families. In the fiscal year 1996 budget we provide for the full pay raise authorized by law for military personnel, and we have budgeted the \$7.7 billion necessary to continue this commitment through the end of the century.

We have also funded several initiatives that are spelled out in my written statement. These include increasing the allowance for quarters for members who live on the civilian economy; implementing a cost-of-living allowance for personnel who live in high cost areas in the United States; providing for the accelerated renovation of military housing units and bachelor's quarters; providing for innovative private sector ventures to secure more housing for our military families; increasing the availability of child care and of family advocacy counseling services; and, of course, improving morale, welfare and recreation services.

Secretary Perry allocated \$450 million to these initiatives in the fiscal year 1996 budget, and has carried forward the funding in the Defense program, a commitment of \$2.7 billion over 6 years. We are firmly committed to providing our men and women in uniform and their families the kind of support they deserve and have earned through their dedication and service to our Nation.

Now, I would like to turn to the primary subject before this Panel today. Our morale, welfare and recreation programs are an integral part of the nonpay package of benefits we provide to our men and women in uniform and their families. These programs provide our people with a real sense of community and provide the support services commonly furnished in civilian communities by employers and local governments.

As successful as the force downsizing has been, it has inevitably resulted in increased turbulence and uncertainty for our people. Our task now is to restore more stability in the military communities. Military life necessarily brings with it an element of uncertainty as our forces must be ready to respond when needed anywhere.

The MWR programs in the Department of Defense are a critical element in our efforts to reduce the stress inherent in military communities. They provide a familiar range of services when families relocate to new posts, support junior enlisted men and women with a wide range of programs and, in the process, add value to the compensation package of our people.

Each installation throughout DOD offers a mix of fitness, recreation, community support, and retail services which are based on local needs. Worldwide, MWR activities serve 12 million patrons, generate over \$2.3 billion in revenues, and employ about 100,000 people.

Most significantly, mission readiness, productivity, and retention are significantly enhanced by quality MWR programs. During contingencies or deployments, MWR programs are mobilized to provide stress relief from the intensity of operations. At the same time, these programs continue to support the family members left behind. In peacetime, MWR programs support military readiness through activities which enhance physical fitness, foster unit cohesion, and promote individual growth and development.

Because these programs directly support family well-being and quality of life, our service members perceive them to be very, very valuable benefits. We have aggressively pursued policy and procedural initiatives to ensure our MWR programs continue to be responsive to the needs of service members and their families.

These initiatives, which are spelled out in my written statement include reconstituting the DOD Executive Resale Board to improve the management of our resale activities; improving program comparability through the setting of more uniform standards; reorganizing and updating departmental directives and instructions to make them more responsive to installation requirements; reengineering our business practices to make them more efficient; improving resource management and long-range financial planning to provide more stability and accountability in our programs; and the development of a 5-year strategic plan to guide us in our future management of MWR programs.

Finally, Mr. Chairman, on behalf of our people in the Department of Defense I would like to express my appreciation to this Panel for the outstanding support you have provided us. The drawdown has been a complex and difficult task. But the Congress, two administrations, and the uniformed military leadership have worked together to maintain a sound MWR program that always puts the needs of our service members first.

Thank you again, Mr. Chairman, for this opportunity to address the Panel. I stand ready with my colleagues to respond to any questions you may have.

STATEMENT OF THE

HONORABLE FREDERICK F.Y. PANG

**ASSISTANT SECRETARY OF DEFENSE
FOR FORCE MANAGEMENT POLICY**

BEFORE THE

PANEL ON MORALE, WELFARE AND RECREATION

OF THE COMMITTEE ON NATIONAL SECURITY

HOUSE OF REPRESENTATIVES

MARCH 29, 1995

GOOD AFTERNOON MR. CHAIRMAN AND MEMBERS OF THE MORALE, WELFARE AND RECREATION PANEL. I WELCOME THE OPPORTUNITY TO APPEAR BEFORE YOU TODAY TO DISCUSS THE MORALE, WELFARE AND RECREATION PROGRAMS OF THE DEPARTMENT OF DEFENSE.

I WILL BE COVERING THREE PRIMARY AREAS IN MY TESTIMONY: FIRST, FORCE MANAGEMENT, INCLUDING THE DRAWDOWN AND STABILIZATION OF FORCES; SECOND, THE DEPARTMENT'S MORALE, WELFARE, AND RECREATION PROGRAMS; AND THIRD, SECRETARY PERRY'S BROADER QUALITY OF LIFE INITIATIVES. I KNOW THAT ALL THREE OF THESE ISSUES ARE IMPORTANT TO THE WORK OF THIS PANEL.

I WOULD LIKE TO BEGIN BY FOCUSING ON OUR GREATEST SUCCESS STORY: THE CAREFUL AND EFFECTIVE WAY IN WHICH WE HAVE HANDLED THE POST-COLD WAR DRAWDOWN.

IN OUR FISCAL YEAR 1996 BUDGET, SECRETARY PERRY ESTABLISHED THREE PRIORITIES FOR THE DEPARTMENT OF DEFENSE:

- MANAGING THE USE OF MILITARY FORCE IN THE POST-COLD WAR ERA.
- PREVENTING THE REEMERGENCE OF A NUCLEAR THREAT.
- AND MANAGING THE DRAWDOWN OF OUR FORCES.

MY OFFICE HOLDS PRIMARY RESPONSIBILITY FOR THE DRAWDOWN, AND I AM PLEASED TO PRESENT A STATUS REPORT ON OUR PROGRESS.

THE DOWNSIZING OF OUR MILITARY FORCE FOLLOWING THE COLD WAR WAS NOT ONLY PRUDENT, BUT NECESSARY. TODAY, OUR DOWNSIZING OF MILITARY PERSONNEL ON ACTIVE DUTY IS OVER 80 PERCENT COMPLETE. THE

REDUCTIONS WE PLAN FOR FISCAL YEAR 1996 WILL ESSENTIALLY COMPLETE THE DRAWDOWN OF OUR ACTIVE FORCES. I CAN REPORT THAT, DESPITE THE UNPRECEDENTED CHALLENGE OF SHRINKING AN ALL-VOLUNTEER FORCE, WE HAVE MET OR EXCEEDED OUR NATIONAL SECURITY OBJECTIVES WITH RESPECT TO THE SIZE AND CAPABILITIES OF OUR ARMED FORCES. BECAUSE OUR MILITARY PERSONNEL LEADERS WERE SKILLFUL IN EXECUTING THIS DRAWDOWN, OUR FORCE TODAY IS MORE EXPERIENCED, OF HIGHER QUALITY, IS MORE DIVERSE, AND HAS THE MIX OF SKILLS NEEDED TO MEET CURRENT AND FUTURE CHALLENGES

IMPORTANTLY, WE HAVE ACHIEVED THIS SUCCESS WHILE TREATING OUR PEOPLE FAIRLY, WHETHER THEY STAYED IN SERVICE OR SEPARATED. EVEN THOUGH THE NUMBER OF ACTIVE DUTY PERSONNEL HAS ALREADY BEEN REDUCED BY MORE THAN 600,000, THE NUMBER OF SERVICEMEMBERS WHO HAVE BEEN INVOLUNTARILY SEPARATED HAS BEEN QUITE SMALL AND MOST OF THOSE WHO HAVE SEPARATED HAVE BEEN SUCCESSFUL IN FINDING CIVILIAN EMPLOYMENT. A GREAT DEAL OF THE CREDIT FOR OUR SUCCESS BELONGS TO THE CONGRESS FOR PROVIDING THE SEPARATION INCENTIVES AND TRANSITION PROGRAMS WE NEEDED TO ENSURE THAT WE KEPT FAITH WITH THOSE WHO SERVED THE NATION.

OUR FOCUS IS NOW SHIFTING TO THE TASK OF STABILIZING THE FORCE. ANY DRAWDOWN OF THIS SIZE, EVEN ONE CAREFULLY AND SUCCESSFULLY MANAGED, WILL CAUSE TURBULENCE -- IT IS AN INEVITABLE BY-PRODUCT OF CHANGE. THEREFORE, WE ARE NOW TAKING STEPS TO RETURN A SENSE OF STABILITY TO THE ARMED FORCES. THE MORALE WELFARE AND RECREATION PROGRAMS OF THE DEPARTMENT OF DEFENSE ARE IMPORTANT TO THIS EFFORT: PARTICULARLY WITH RESPECT TO THE SUPPORT THEY PROVIDE TO JUNIOR ENLISTED MEMBERS OF OUR ARMED FORCES.

FOR THE 1.5 MILLION MEN AND WOMEN WHO REMAIN ON ACTIVE DUTY, THIS ADMINISTRATION HAS ESTABLISHED AND FUNDED AN EXTRAORDINARY PROGRAM TO SUPPORT THEM AND THEIR FAMILIES. FIRST, PRESIDENT CLINTON AND SECRETARY PERRY ARE DETERMINED TO SPEND THE \$7.7 BILLION NECESSARY TO SEE THAT SERVICEMEMBERS GET THE MAXIMUM PAY RAISE ALLOWED BY LAW THROUGH THE END OF THE CENTURY. ADDITIONALLY, SECRETARY PERRY HAS ANNOUNCED A MAJOR QUALITY OF LIFE INITIATIVE, WHICH I WILL OUTLINE IN A MOMENT.

OUR JOB IS TO SUPPORT THE MEN AND WOMEN WHO PROTECT THIS COUNTRY. IN OUR EVERY DECISION, OUR TEST WILL BE: WILL THIS IMPROVE LIFE FOR THE ARMY CAPTAIN AT FORT BRAGG? WILL THE YOUNG AIRMAN IN TRAINING AT SHEPPARD AIR FORCE BASE HAVE THE RECREATIONAL OPPORTUNITIES HE OR SHE DESERVES WHILE LEARNING HOW TO MAINTAIN FIGHTER AIRCRAFT? IS THE HIGH SCHOOL GRADUATE WITH A DREAM OF GOING TO PARRIS ISLAND STILL INTERESTED WHEN HE HEARS THE DETAILS OF MILITARY PAY AND BENEFITS? AND, WILL THE DAUGHTER OF A PETTY OFFICER ON THE EISENHOWER FEEL GOOD ENOUGH ABOUT MILITARY LIFE TO STUDY HARD AND WORK TOWARD GOING TO THE NAVAL ACADEMY?

MORALE WELFARE AND RECREATION PROGRAMS

I WANT TO NOW TURN TO THE REASON MY COLLEAGUES AND I ARE HERE TODAY -- TO DISCUSS WITH YOU THE CURRENT STATUS OF OUR MORALE, WELFARE, AND RECREATION, OR MWR, PROGRAMS. THESE PROGRAMS FORM AN INTEGRAL PART OF THE NON-PAY COMPENSATION BENEFITS PACKAGE FOR MILITARY MEMBERS. THEY PROVIDE MEMBERS AND THEIR FAMILIES WITH A REAL SENSE OF COMMUNITY AND PROVIDE THE SUPPORT SERVICES COMMONLY FURNISHED IN CIVILIAN COMMUNITIES BY EMPLOYERS AND LOCAL GOVERNMENTS. MWR PROGRAMS SUPPORT THE OVERALL READINESS OF THE

FORCE BY AIDING IN THE RECRUITMENT AND RETENTION OF PERSONNEL AND ENCOURAGING POSITIVE INDIVIDUAL VALUES. THESE PROGRAMS PROVIDE FOR THE PHYSICAL, CULTURAL, AND SOCIAL NEEDS AND GENERAL WELL-BEING OF SERVICEMEMBERS AND THEIR FAMILIES. THEY PROVIDE COMMUNITY SUPPORT SYSTEMS THAT MAKE MILITARY INSTALLATIONS TEMPORARY HOMETOWNS FOR A MOBILE MILITARY POPULATION.

BEFORE MOVING ON, I'D LIKE TO DESCRIBE SOME RECENT EVENTS THAT ILLUSTRATE THE ROLE OF MWR PROGRAMS. OUR MWR PROGRAMS PROVIDE OUR SERVICE MEMBERS AND THEIR FAMILIES WITH A SENSE OF COMMUNITY WHERE EVER THEY ARE STATIONED. THAT SENSE OF COMMUNITY CREATES AN EXTENDED FAMILY AND FOSTERS A CULTURE THAT VALUES EVERY MEMBER AND RALLIES TO THEIR SUPPORT IN TIMES OF CRISIS. THESE ARE TRUE COMMUNITIES OF EXCELLENCE, REPRESENTING THE AMERICAN SPIRIT. THE IMPORTANCE OF MAINTAINING THE MILITARY CULTURE CAN NOT BE UNDERSTATED.

LET ME GIVE YOU AN EXAMPLE OF WHAT ALL THIS MEANS FOR OUR SERVICE MEMBERS AND WHY THEY PERCEIVE THESE PROGRAMS TO BE A VALUED BENEFIT. WHEN NAVY AND MARINE FAMILIES, AND CIVILIANS WERE EVACUATED FROM GUANTANAMO BAY, THEY SUDDENLY FOUND THEMSELVES WITHOUT THEIR SPOUSES, THEIR POSSESSIONS, OR THEIR SUPPORT SYSTEMS. UPON ARRIVING, HOWEVER, IN NORFOLK, THE MILITARY COMMUNITY IMMEDIATELY TOOK OVER, PROVIDING THESE FAMILIES WITH THE THINGS THEY NEEDED TO EASE THEIR ADJUSTMENT. THAT'S WHAT A MILITARY COMMUNITY IS ALL ABOUT. THAT'S WHAT WE FOSTER IN BUILDING OUR MILITARY CULTURE. THE MWR PROGRAMS, AS THEY PROVIDE FOR THE PSYCHOLOGICAL AND PHYSIOLOGICAL NEEDS OF OUR SERVICE MEMBERS AND THEIR FAMILIES, PLAY A VITAL ROLE IN BUILDING THAT COMMUNITY AND CULTURE. THESE ARE THE KEYS TO RECRUITING AND RETAINING THE FORCE.

EACH INSTALLATION THROUGHOUT DOD OFFERS A MIX OF FITNESS, RECREATION, COMMUNITY SUPPORT AND RETAIL SERVICES WHICH ARE BASED ON LOCAL PATRON NEEDS. WORLDWIDE, MWR ACTIVITIES SERVE 12 MILLION PATRONS, GENERATE OVER \$2.3 BILLION IN REVENUES, AND EMPLOY ABOUT 100,000 PEOPLE.

MOST SIGNIFICANTLY, MISSION READINESS AND PRODUCTIVITY ARE SIGNIFICANTLY ENHANCED BY QUALITY MWR PROGRAMS. DURING CONTINGENCIES OR DEPLOYMENTS, MWR PROGRAMS ARE MOBILIZED TO PROVIDE STRESS RELIEF AND ASSIST IN UNIT COHESION. AT THE SAME TIME THESE PROGRAMS CONTINUE TO SUPPORT THE FAMILY MEMBERS LEFT BEHIND BY MEETING THEIR RECURRING AND SPECIFIC NEEDS. IN PEACETIME, MWR PROGRAMS SUPPORT MILITARY READINESS THROUGH PHYSICAL FITNESS, ADDRESSING NEEDS FOR CAMARADERIE AND UNIT COHESION, AND BY PROMOTING INDIVIDUAL GROWTH AND DEVELOPMENT. THESE PROGRAMS ARE IMMENSELY IMPORTANT TO SINGLE MEMBERS, PARTICULARLY JUNIOR ENLISTED MEMBERS. BECAUSE THEY DIRECTLY SUPPORT FAMILY WELL BEING AND QUALITY OF LIFE, OUR SERVICEMEMBERS AND THEIR FAMILIES PERCEIVE MWR PROGRAMS TO BE A VALUABLE BENEFIT.

AS A RESULT OF CONCERN OVER THE ROLES, MISSIONS AND MANAGEMENT OF THE MWR PROGRAMS, IN 1987, THE DEPARTMENT, IN PARTNERSHIP WITH THE CONGRESS, REASSESSED PROGRAM AUTHORIZATIONS, ORGANIZATION AND STAFFING, AND FUNDING POLICIES. THE MORALE, WELFARE AND RECREATION PROGRAMS WERE REDESIGNED TO CLEARLY DELINEATE THE ESSENTIALITY OF ACTIVITIES AND THE FUNDING STRUCTURE.

MWR PROGRAMS RECEIVE SUPPORT FROM TWO SOURCES: FIRST, NONAPPROPRIATED FUNDS GENERATED BY SALES, FEES AND EXCHANGE

DIVIDENDS, AND SECONDLY, FROM APPROPRIATED FUND SUPPORT PRIMARILY PROVIDED BY OPERATIONS AND MAINTENANCE, MILITARY PERSONNEL, AND MILITARY CONSTRUCTION APPROPRIATIONS.

THE RESTRICTIONS ON THE USES OF APPROPRIATED FUNDING CAN BEST BE DESCRIBED BY LOOKING ACROSS A CONTINUUM OF ACTIVITIES OFFERED AS PART OF AN INSTALLATION'S MWR PROGRAM. ACTIVITIES RANGE FROM THOSE THAT ARE CONSIDERED ESSENTIAL TO ACCOMPLISHING THE MILITARY MISSION TO THOSE THAT ARE DESIRABLE IN TERMS OF THE MILITARY COMMUNITY. ONE GENERALIZATION ABOUT THIS CONTINUUM IS THAT, CHARACTERISTICALLY, THE CAPABILITY TO GENERATE REVENUE IS INVERSELY RELATED TO THE DEGREE OF ESSENTIALITY TO THE MISSION.

TO ASSURE WELL ROUNDED AND COMPARABLE MWR PROGRAMS, AND UNIFORMITY IN THE MANAGEMENT, CONTROL, FUNDING, AND FINANCIAL REPORTING, THESE PROGRAMS ARE DIVIDED INTO THREE CATEGORIES. THESE CATEGORIES -- A, B, AND C -- RELATE TO THE CENTRAL PURPOSE OF THE MWR PROGRAMS. THE EXTENT TO WHICH A PROGRAM MAY USE APPROPRIATED FUNDS, NONAPPROPRIATED FUNDS (NAF), OR A MIX OF BOTH IS DIRECTLY RELATED TO THE PURPOSE OF THE MWR PROGRAM AS REFLECTED BY THE CATEGORY TO WHICH IT IS ASSIGNED. ALLOW ME TO BRIEFLY REVIEW THE THREE CATEGORIES OF MWR PROGRAMS:

CATEGORY A: MISSION SUSTAINING PROGRAMS. INCLUDED IN CATEGORY A ARE THOSE PROGRAMS MOST ESSENTIAL TO MEETING THE ORGANIZATIONAL OBJECTIVES OF THE MILITARY SERVICES BY PROMOTING THE PHYSICAL AND MENTAL WELL-BEING OF THE MILITARY MEMBER. THESE PROGRAMS SHOULD BE FUNDED ALMOST ENTIRELY WITH APPROPRIATED FUNDS, ALTHOUGH IN SPECIFIC SITUATIONS NONAPPROPRIATED FUNDS MAY BE USED WHEN THEY ARE ESSENTIAL FOR THE OPERATION OF A CATEGORY A FACILITY OR PROGRAM.

THESE PROGRAMS CANNOT GENERATE REVENUES. CATEGORY A PROGRAMS INCLUDE:

- PHYSICAL FITNESS CENTERS
- LIBRARIES
- RECREATION CENTERS AND UNIT RECREATION ROOMS
- INDIVIDUAL, UNIT AND INSTALLATION SPORTS AND ATHLETICS PROGRAMS
- UNIT LEVEL ACTIVITIES.

CATEGORY B: BASIC COMMUNITY SUPPORT. LIKE CATEGORY A PROGRAMS, CATEGORY B PROGRAMS SATISFY THE BASIC PHYSIOLOGICAL AND PSYCHOLOGICAL NEEDS OF OUR SERVICEMEMBERS AND THEIR FAMILIES. THESE SUPPORT PROGRAMS ALSO RECEIVE SIGNIFICANT APPROPRIATED FUND SUPPORT BUT DIFFER FROM CATEGORY A PROGRAMS, IN PART, BECAUSE OF THEIR ABILITY TO GENERATE LIMITED NONAPPROPRIATED FUND REVENUES. CATEGORY B PROGRAMS PROVIDE COMMUNITY SUPPORT SYSTEMS THAT MAKE MILITARY INSTALLATIONS TEMPORARY HOMETOWNS FOR OUR MOBILE MILITARY POPULATION. PROGRAMS THAT FALL IN THIS CATEGORY INCLUDE:

- CHILD DEVELOPMENT CENTERS
- ARTS AND CRAFTS SKILLS CENTERS
- AUTOMOTIVE SKILL DEVELOPMENT
- OUTDOOR RECREATION
- RECREATION INFORMATION, TICKETS, AND TOURS
- RECREATIONAL SWIMMING POOLS
- YOUTH ACTIVITIES

CATEGORY C: REVENUE GENERATING ACTIVITIES. CATEGORY C ACTIVITIES ARE OUR BUSINESS OPERATIONS. THESE ACTIVITIES ARE CAPABLE OF GENERATING ENOUGH REVENUE THROUGH THE SALE OF GOODS AND SERVICES TO COVER THE MAJORITY OF THEIR OPERATING EXPENSES. WHILE CATEGORY C

PROGRAMS APPEAL MOSTLY TO INDIVIDUAL NEEDS, THEY DO IMPACT ON RECRUITING AND RETENTION BY CONTRIBUTING TO AN OVERALL SENSE OF COMMUNITY AND QUALITY OF LIFE, ESPECIALLY AT DESIGNATED REMOTE AND ISOLATED LOCATIONS. THESE PROGRAMS MAY RECEIVE THE SAME TYPE OF APPROPRIATED FUND SUPPORT AS CATEGORY B PROGRAMS. CATEGORY C PROGRAMS INCLUDE:

- ARMED FORCES RECREATION CENTERS AND JOINT SERVICE FACILITIES
- BOWLING
- LODGING/GUEST QUARTERS
- CLUBS
- GOLF COURSES
- MARINAS
- MOTION PICTURE FACILITIES (PAID ADMISSION)
- STABLES

ALTHOUGH NOT INCLUDED IN OUR DISCUSSIONS TODAY, THE MILITARY EXCHANGES ARE CONSIDERED CATEGORY C MWR ACTIVITIES.

MORALE, WELFARE AND RECREATION PROGRAM INITIATIVES

TO KEEP PACE WITH THE MYRIAD OF CHANGES RESULTING FROM THE FORCE DRAWDOWN, THE DEPARTMENT HAS AGGRESSIVELY PURSUED POLICY AND PROCEDURAL INITIATIVES TO ENSURE OUR MWR PROGRAMS CONTINUE TO BE RESPONSIVE TO THE NEEDS OF OUR SERVICEMEMBERS AND FAMILIES. WE HAVE, OVER THE PAST YEAR, SIGNIFICANTLY IMPROVED THE OVERSIGHT OF THESE PROGRAMS. WE HAVE ALSO MADE CONSIDERABLE PROGRESS IN FOSTERING ECONOMIES AND EFFICIENCIES IN OUR PROGRAMS THROUGH COOPERATIVE EFFORTS BETWEEN THE MORALE, WELFARE AND RECREATION PROGRAMS, THE EXCHANGE PROGRAMS, AND THE COMMISSARY AGENCY. I

WOULD LIKE TO HIGHLIGHT SOME OF OUR MOST SIGNIFICANT ACCOMPLISHMENTS MADE OVER THE PAST YEAR.

DOD EXECUTIVE RESALE BOARD

I AM PLEASED TO REPORT THAT THE DEPARTMENT REACTIVATED THE DOD EXECUTIVE RESALE BOARD, THEREBY PROVIDING THE MILITARY SERVICES' MWR DIRECTORS, EXCHANGE SERVICE COMMANDERS AND THE COMMANDER OF THE DEFENSE COMMISSARY AGENCY (DECA) THE OPPORTUNITY TO COLLECTIVELY EXPLORE RESALE MANAGEMENT ISSUES IN AN EFFORT TO DETERMINE THE MOST EFFICIENT AND EFFECTIVE WAY OF MANAGING THEIR RESALE BUSINESSES. THE DOD EXECUTIVE RESALE BOARD CONTINUES TO ACTIVELY PURSUE A VARIETY OF SIGNIFICANT ISSUES INCLUDING COOPERATIVE INITIATIVES IN THE RESALE COMMUNITY AND INNOVATIVE CONCEPTS FOR THE DELIVERY OF PROGRAMS AND SERVICES.

I HAVE RECENTLY CHARGED THE MWR, EXCHANGE SERVICES AND DECA DIRECTORS WITH DEVELOPING ADDITIONAL COOPERATIVE EFFORTS. THE DIRECTORS MET EARLIER THIS MONTH TO DEVELOP A STRATEGY FOR INCREASING COOPERATIVE EFFORTS. THEY WILL REPORT THEIR RESULTS THROUGH THE DEPARTMENT'S QUALITY OF LIFE TASK FORCE.

PROGRAM COMPARABILITY

IT IS CLEAR THAT TODAY OUR SOLDIERS, SAILORS, AIRMEN AND MARINES DO NOT ALL ENJOY COMPARABLE LEVELS OF MWR PROGRAM SUPPORT. THIS ISSUE HAS RECEIVED SIGNIFICANT ATTENTION AT ALL LEVELS WITHIN THE DEPARTMENT AND THE MILITARY SERVICES. I AM PLEASED TO INFORM YOU THAT WE HAVE TAKEN, AND WILL CONTINUE TO TAKE, AGGRESSIVE ACTION TO PROVIDE COMPARABLE MORALE WELFARE AND RECREATION PROGRAMS TO ALL OUR SERVICEMEMBERS. IN FISCAL YEAR 1994, THE NAVY MORALE, WELFARE AND RECREATION PROGRAM RECEIVED A \$65 MILLION INCREASE. THE

MARINE CORPS PROGRAM RECEIVED A \$10 MILLION PLUS-UP IN FISCAL YEAR 1995 AND A \$42 MILLION INCREASE IS BUDGETED FOR FISCAL YEAR 1996.

ADDING MONEY WITHOUT SETTING PROGRAM GOALS AND MEASURES, HOWEVER, WILL NOT NECESSARILY GIVE US THE PROGRAMS WE NEED. THEREFORE, THE DEPARTMENT HAS UNDERTAKEN A MAJOR INITIATIVE TO DEVELOP AND IMPLEMENT OVERALL PROGRAM GOALS AND EFFECTIVENESS MEASURES.

THE FISCAL YEAR 1996 BUDGET CONTAINS THE FUNDING FLOOR FOR COMPARABILITY - \$295 DOLLARS PER SERVICEMEMBER. I SHOULD POINT OUT THAT THIS MINIMUM STANDARD FOR PER CAPITA SUPPORT IS USED TO MEASURE ONLY THE DIRECT OPERATIONS AND MAINTENANCE SUPPORT FOR PERSONNEL, SUPPLIES, AND EQUIPMENT.

THE FISCAL YEAR 1994 ANNUAL REPORTS ARE JUST NOW COMING IN FROM THE SERVICES. AS WE COMPILE AND ANALYZE THE DATA WE WILL LOOK FOR MOVEMENT TOWARD THE \$295 FLOOR AND THE OVERALL RELATIONSHIP BETWEEN APPROPRIATED AND NONAPPROPRIATED FUNDS IN EACH OF THE FUNDING CATEGORIES.

DEPARTMENT DIRECTIVES AND INSTRUCTIONS

IN THIS RESPECT, WE HAVE RECOGNIZED THAT OUR EXISTING DIRECTIVES AND INSTRUCTIONS NO LONGER PROVIDE FULLY ADEQUATE DIRECTION FOR THE MANAGEMENT OF OUR MORALE, WELFARE AND RECREATION PROGRAMS. A MAJOR INITIATIVE IS NOW UNDERWAY TO REORGANIZE AND UPDATE ALL OUR MWR PROGRAM AND FINANCIAL DIRECTIVES AND INSTRUCTIONS. OUR PLAN IS TO POSTURE THESE DIRECTIVES TO ENSURE THEY MEET THE EVOLVING NATURE OF THE FORCE, MWR PROGRAMS AND SERVICE PRIORITIES.

BUSINESS PROCESS IMPROVEMENT

IMPROVING THE WAY TO DO BUSINESS IS KEY TO THE SUCCESS OF OUR PROGRAMS. NOT LONG AGO, WE BEGAN A MAJOR EFFORT TO ANALYZE THE MANAGEMENT PRACTICES AND POLICIES OF THE MWR PROGRAMS IN ORDER TO DETERMINE IF THERE WERE POSSIBLE BUSINESS PROCESS IMPROVEMENTS THAT WOULD GENERATE SAVINGS AND EFFICIENCIES. THIS JOINT SERVICE EFFORT INITIALLY IDENTIFIED 14 OPPORTUNITIES FOR BUSINESS PROCESS IMPROVEMENTS. AS A RESULT OF THIS EFFORT THE DEPARTMENT AND MILITARY SERVICES WILL EXPLORE MAJOR RE-ENGINEERING EFFORTS IN TWO AREAS: CASH MANAGEMENT AND NON-HEALTH BENEFIT PROGRAMS.

BENEFITS FOR NONAPPROPRIATED FUND EMPLOYEES

THE DEPARTMENT'S NONAPPROPRIATED FUND EMPLOYEES -- THE 180,000 INDIVIDUALS WHO WORK IN OUR EXCHANGES, CHILD CARE FACILITIES AND MANY OF OUR MWR PROGRAMS -- ARE NOT CIVIL SERVICE EMPLOYEES. THE EXCHANGES AND THE MWR PROGRAMS OF THE MILITARY SERVICES PROVIDE NONAPPROPRIATED FUND EMPLOYEES WITH THEIR OWN BENEFITS PACKAGES. IN KEEPING WITH CONGRESSIONAL DIRECTION, WE ARE IN THE PROCESS OF CONTRACTING WITH AN EMPLOYEE BENEFITS CONSULTING FIRM TO DEVELOP A UNIFORM HEALTH BENEFIT PLAN CONSISTENT WITH RESOURCE AVAILABILITY.

WE ARE ALSO COMPLETING A STUDY ON THE IDEA OF PROVIDING CIVIL SERVICE RETIREMENT CREDIT TO CERTAIN EMPLOYEES WHO MOVED BETWEEN NONAPPROPRIATED FUND AND CIVIL SERVICE RETIREMENT SYSTEMS AND WHO ARE NOT COVERED BY THE RECENT PORTABILITY ACT. WE WILL PROVIDE OUR REPORT IN APRIL.

RESOURCE MANAGEMENT AND LONG RANGE FINANCIAL PLANNING

UNDERSTANDING THE COMPLEXITIES OF THE RESOURCE MANAGEMENT OF THE MORALE, WELFARE AND RECREATION PROGRAMS IS VITAL TO ENSURING

PROPER STEWARDSHIP OF BOTH APPROPRIATED AND NONAPPROPRIATED RESOURCES. SEVERAL KEY ACTIONS TAKEN THIS PAST YEAR TO IMPROVE THE RESOURCE MANAGEMENT OF THESE PROGRAMS INCLUDE: THE DEVELOPMENT OF NEW POLICIES ON ISSUANCE OF CREDIT; ESTABLISHMENT OF THE FIVE YEAR FINANCIAL PLAN; AND THE DEVELOPMENT OF A SINGLE COMMISSARY SURCHARGE AND NONAPPROPRIATED FUND MAJOR CONSTRUCTION SUBMISSION.

A FIVE YEAR PLAN

THE DEPARTMENT IS BREAKING NEW GROUND IN DEVELOPING A FIVE YEAR PLAN. I WOULD LIKE TO BRIEFLY EXPLAIN THE PURPOSE AND SCOPE OF THIS EFFORT.

THIS TOOL RECOGNIZES THE INTERRELATIONSHIP AMONG THESE PROGRAMS AND COLLECTIVELY EXAMINES THE RESOURCING REQUIREMENTS, PATRON BASE, PROGRAM VIABILITY, AND CONSTRUCTION PLANS AS A WAY TO ASSESS FUTURE TRENDS IN THESE PROGRAMS. IN THE FALL OF 1994, THE MWR DIRECTORS, EXCHANGE SERVICE COMMANDERS AND THE COMMISSARY COMMANDER DEVELOPED THEIR DRAFT FIVE YEAR FINANCIAL PLANS AS THE FIRST STEP IN SYSTEMATICALLY GATHERING THIS CRITICAL DATA. THE FIRST DRAFT CLEARLY SHOWED US THE POTENTIAL OF THIS TOOL IN ASSISTING IN THE OVERALL MANAGEMENT OF THESE PROGRAMS AND POINTED OUT THE NEED TO RATIONALIZE ALL OUR FINANCIAL REPORTING REQUIREMENTS.

I WOULD LIKE TO TURN NOW TO SOME OTHER IMPORTANT AREAS IN OUR MWR PROGRAMS.

CHILD CARE

SERVICEMEMBERS ARE PARENTS TO 1.1 MILLION CHILDREN UNDER THE AGE OF TWELVE. RELIABLE, HIGH QUALITY CHILD CARE HELPS MILITARY FAMILIES

ACHIEVE ECONOMIC SECURITY IN A TIME WHEN TWO INCOMES ARE OFTEN ESSENTIAL. NOT ONLY IS THE DEPARTMENT OF DEFENSE THE LARGEST PROVIDER OF CHILD CARE IN THE WORLD, BUT DOD CHILD DEVELOPMENT SERVICES HAVE BEEN HERALDED AS A ROLE MODEL FOR OTHER GOVERNMENT AGENCIES AND THE NATION AS A WHOLE. THE DEPARTMENT HAS A POTENTIAL CHILD CARE NEED FOR 312,000 SPACES IN AN ACTIVE FORCE OF 1.45 MILLION AND CURRENTLY HAS APPROXIMATELY 167,000 SPACES. FUNDING WAS INCREASED IN FISCAL YEAR 1995 BY \$35 MILLION AND WILL BE INCREASED BY \$38.1 MILLION IN FISCAL YEAR 1996 AS PART OF SECRETARY PERRY'S QUALITY OF LIFE INITIATIVES.

YOUTH PROGRAMS

WE ARE ALSO CONCERNED ABOUT THE GENERAL WELFARE OF YOUTH ON INSTALLATIONS, WHO ARE NOT IMMUNE TO THE FORCES OF VIOLENCE AND GANG ACTIVITY WHICH TROUBLE THE NATION AS A WHOLE. IN ADDITION TO MAINTAINING YOUTH ACTIVITY CENTERS, WHICH FEATURE SOCIAL AND RECREATIONAL ACTIVITIES, WE HAVE BEGUN SUPPORTING LOCALLY DEVELOPED CHILD AND ADOLESCENT SUPPORT PROJECTS THROUGH THE MODEL COMMUNITIES INCENTIVE AWARDS PROGRAM.

SECRETARY PERRY'S QUALITY OF LIFE INITIATIVE

I WOULD LIKE TO TURN NOW TO ONE OF THE MOST DRAMATIC AND IMPORTANT ELEMENTS OF OUR MILITARY PERSONNEL PLANS -- SECRETARY PERRY'S QUALITY OF LIFE INITIATIVE. THIS INITIATIVE WILL GREATLY ENHANCE MANY OF OUR MORALE, WELFARE, AND RECREATION PROGRAMS.

THE PRESIDENT AND SECRETARY PERRY ARE DETERMINED TO GIVE MILITARY PERSONNEL AND THEIR FAMILIES THE KIND OF SUPPORT THEY DESERVE AND

HAVE EARNED BY THEIR SERVICE TO THE NATION. IT IS A MATTER BOTH OF BASIC FAIRNESS AND OF MILITARY READINESS. IF THE DEPARTMENT OF DEFENSE CANNOT CONTINUE TO ATTRACT AND RETAIN HIGH CALIBER PEOPLE TO MILITARY SERVICE, THE QUALITY OF OUR NATIONAL SECURITY WILL BE ENDANGERED. IF SOLDIERS, SAILORS, AIRMEN, AND MARINES CANNOT CONCENTRATE ON THE MISSION AT HAND BECAUSE THEY ARE WORRIED ABOUT THEIR FAMILIES AND THEIR FUTURES, WE WILL HAVE JEOPARDIZED OUR ABILITY TO ACCOMPLISH THAT MISSION.

THE QUALITY OF LIFE INITIATIVE HAS THREE MAJOR COMPONENTS: RAISING COMPENSATION, IMPROVING THE QUANTITY AND QUALITY OF HOUSING, AND BOLSTERING OUR COMMUNITY AND FAMILY SUPPORT PROGRAMS. THE DEPARTMENT OF DEFENSE WILL SPEND \$2.7 BILLION OVER THE NEXT FIVE YEARS TO IMPROVE HOUSING, EXPAND CHILD CARE, SUPPLEMENT THE INCOME OF SERVICEMEMBERS ASSIGNED TO HIGH COST AREAS IN THE UNITED STATES, NARROW THE HOUSING COST GAP, IMPROVE MORALE AND RECREATION SERVICES, AND PROVIDE OTHER BENEFITS FOR THE MEMBERS AND THEIR FAMILIES. OUR FISCAL YEAR 1996 BUDGET CONTAINS AN INITIAL INVESTMENT OF \$450 MILLION FOR THESE INITIATIVES, \$94 MILLION OF WHICH SUPPORT OUR MORALE, WELFARE AND RECREATION PROGRAMS, CHILD CARE AND COMMUNITY AND FAMILY SUPPORT PROGRAMS, AND WE PLAN TO INCLUDE THE SAME AMOUNT EACH YEAR FOR THE FOLLOWING FIVE YEARS. THIS INITIATIVE IS NOT ONLY A MATTER OF BASIC FAIRNESS TO THE PEOPLE WHO DEFEND OUR NATION; IT WILL IMPROVE THE READINESS AND EFFECTIVENESS OF OUR FORCES.

THANK YOU, MR. CHAIRMAN, FOR THE OPPORTUNITY TO OUTLINE THE DEPARTMENT'S WORK IN THIS AREA. I WOULD BE PLEASED TO ANSWER ANY QUESTIONS YOU MAY HAVE.

Mr. MCHUGH. Thank you, Secretary Pang. Before we proceed, let me draw to the attention of the Panel and the rest of the members who have joined us since we began. First of all, the gentleman from Texas, Mr. John Tanner.

Mr. TANNER. Tennessee. [Laughter.]

Mr. MCHUGH. I was looking at Mr. Ortiz and I just thought Lone Star State.

Mr. TANNER. Davy Crockett was one of my predecessors in office, so I guess we are responsible for Texas. I hope no one holds us to that. [Laughter.]

Mr. MCHUGH. Also, the gentleman from Oklahoma, Mr. J.C. Watts, and the gentleman from Virginia, Mr. Herb Bateman. So welcome to all of you.

It is the thought of the chair, unless there is an objection or a concern to the contrary, that we hear from all of the panel witnesses and then address our questions to them en masse. If that meets with everyone's approval, I will next recognize, moving from one end of the table to the other, not necessarily by rank or by admiration, Brig. Gen. John Meyer, whom we all admire very greatly.

STATEMENT OF BRIG. GEN. JOHN G. MEYER, COMMANDER, ARMY COMMUNITY AND FAMILY SUPPORT CENTER, U.S. ARMY

General MEYER. Thank you, Mr. Chairman. It is always great to start out that way. Mr. Chairman, and members of the Panel, I welcome the opportunity to appear before you today to discuss the direction of Army morale, welfare, and recreation programs. I submitted my statement for the record and have a few brief comments.

The role of MWR programs in today's Army is clear. They not only support the mental and physical readiness of the force, but are essential components to readiness, retention, and quality of life for America's Army. Our challenge for the future is to deliver comprehensive programs in a downsized environment while simultaneously shaping them to meet the needs of the future force. Both the Department of Defense and the Army Secretariat provide strong, yet flexible, policy and supervision upon which to shape our future.

The Army Chief of Staff challenged his MWR Board of Directors, the senior Army field commanders, to set forth viable strategies and invent the future. Consequently, we developed the Army MWR strategic vision for the 21st century. This was a milestone event. It brought to fruition an effort long recognized as necessary but frequently frustrated by parochial interests.

We also developed an Army MWR strategic action plan that charts over 200 actions that will help us achieve our vision; namely, a more efficient, effective, customer focused MWR program. This focus dictates we evaluate our traditions and old habits to identify and eliminate those non-value added practices ensuring we challenge any bureaucratic impediment.

As the Army moves forward, we will continue to place emphasis on fiscal performance and oversight to ensure adequate capital for long-term reinvestment in our facilities and our personnel. Implementation of the congressional mandate to consolidate excess, nonappropriated cash in an Army level account was a tough sell to the installations where the money was generated. However, it was

the right decision. It will eventually ensure that all of America's Army is provided similar levels of service regardless of where they are stationed.

The Army's capital reinvestment assessment is an example of our break with tradition. It will ensure continued compliance with congressional intent while providing incentive to installation commanders to manage efficiently. For fiscal year 1996, 2 percent of an installation's total revenue will be consolidated to ensure adequate resources for future capital investment.

In yet another break with tradition, we are pursuing cooperative ventures with other service MWR programs with various exchange resale activities in the Department and the Defense Commissary Agency. These examples of collaboration will improve all MWR programs and maximize the benefit to soldiers, sailors, airmen and marines, and their families.

As we continue to strive for increased efficiencies, we will not lose sight of the impact of programs on the individual soldier and on family members. Safe, affordable child care and youth programs reduce the stress between family responsibilities and mission requirements. Gymnasiums, unit sports, libraries, and other recreation programs contribute directly to the fitness and well-being of our soldiers.

Army family team building and Army community services contribute to the readiness of the individual family and community before and after mobilization and deployment. We must maintain the right mix of these programs to sustain soldiers and their families whether at home, abroad, or deployed.

While the Army, in the very near future, will seek the committee's support on some key initiatives, the Army stands ready to support the committee in any way possible. Open and frank communication and participation is essential to providing the best possible MWR programs for soldiers and their families. The Army remains firmly committed to providing a quality of life for soldiers and their families commensurate with that of the communities of the Nation they are pledged to defend.

Thank you again, Mr. Chairman, and other members of the panel for this opportunity. I will respond to any questions that you may have.

**STATEMENT BY
BRIGADIER GENERAL JOHN G. MEYER, JR.
COMMANDER, US ARMY COMMUNITY AND FAMILY SUPPORT CENTER
ON MORALE, WELFARE, AND RECREATION (MWR)**

Mr. Chairman and Members of the Panel, I welcome the opportunity to appear before you today to discuss the status and direction of Army Morale, Welfare and Recreation (MWR) Programs. The role of MWR programs in today's Army is clear. They not only support the mental and physical readiness of the force, but are key components in the Quality of Life (QOL) umbrella necessary to attract and retain the excellent soldiers that are critical to Army Force XXI "manprint" models. Our challenge is to not only continue to provide these programs in a downsizing environment, but to re-engineer them to meet the needs of the future force.

The Army exerted considerable effort over the past few years to strengthen its oversight of Morale, Welfare, and Recreation. We have a collaborative effort among the Army Secretariat, the Community and Family Support Center, the Major Army Commands, and Installation Commanders that ensures judicious stewardship of "soldier dollars." In keeping with traditional roles, the Army Secretariat provides strong policy direction and oversight to our programs. The Major Army Commanders are important players in molding the future direction of MWR through their roles in our planning process which involves participation on the Finance, Audit, and Strategic Planning Committees. In this process the Major Army Commanders ultimately review our annual goals, objectives, and plans to ensure they meet the needs of soldiers and family members.

The Army published a vision for the future of MWR. It addresses leadership's role in the evolution of our programs to become effective, efficient, and customer focused. We distinguish between tradition and habit, discarding non-value added practices while preserving our heritage. Additionally, our continuing emphasis on financial performance and oversight will lead to a capital reinvestment strategy that supports our operations in the long term.

These key themes are developed in a detailed Strategic Action Plan. The plan was developed as a cooperative effort by all echelons of the Army MWR organization, ensuring both representation and "buy-in." It was recognized from the outset as a living document that will evolve with the Army into the next century. Actions, responsibilities, and timelines are identified for management initiatives. Each echelon will define its role in attaining the desired outcomes. Subsequent refinements will provide the framework for a continuous improvement cycle which is the core of organizational excellence concepts. The end result is an MWR organization open to change and committed to meeting the needs of America's Army.

WHAT WE DO

MWR is a package of activities and programs that support quality of life. Perceptions of MWR programs vary based on the perspective of the observer. The soldier participating in Army sports sees a different MWR than the one viewed from the library or recreation center. A sponsor's child who is active in the Youth Services program views MWR differently than does the golfer, the bowler, the amateur entertainer, the self-help automotive repairman, or the amateur photographer. Simply stated, MWR serves all members of America's Army through its broad spectrum of activities and delivery systems.

HOW WE DO IT

MWR programs and activities fall into three categories:

Category A programs are mission sustaining and are primarily funded with appropriated funds (APF). Category A includes such programs as physical fitness, libraries, recreation centers, and unit activities.

Category B encompasses basic community support programs such as child development, youth services, arts and crafts, auto crafts, outdoor recreation, and entertainment. Category B activities are funded with both APF and nonappropriated funds (NAF) or soldier generated dollars for operations, but only Child Development Centers are constructed with appropriated funds. This method of shared resourcing is typical of the manner in which most municipalities fund similar community service operations.

Category C business activities include bowling, golf, the Army Recreation Machine Program (ARMP), clubs, and Armed Forces Recreation Centers (AFRC's). Category C is generally funded with self-generated NAF.

The funding sources for MWR programs are not isolated elements. They must be viewed from the perspective of the integrated whole of the programs they support. Our ball courts which support unit level sports also serve as a resource for youth recreation programs and may be the designated site of pre-deployment briefings or other unit functions. The breaks are rarely that clear. The line between soldier fitness and individual recreation may blur. Army MWR manages programs ranging from human services to individual development and leisure travel, a span of control far broader than that of most municipalities. In providing these programs and services, we do so without the tools available to our municipal counterparts to raise monies for capital investment and programming.

RESOURCING

The Army MWR program's dual funding sources--appropriated funds (APF) and nonappropriated funds (NAF)--are impacted by force restructuring and resultant Defense resource decisions.

Appropriated Funds (APF): Operation and Maintenance, Army (OMA) and Military Construction, Army (MCA) are the primary funding sources for MWR operations. Overall APF support to MWR declined in fiscal year (FY) 93 and FY 94. Unchecked, this would inevitably have affected soldier and family satisfaction and our ability to retain the best and most qualified. To reverse this trend, the Army increased FY 95 MWR funding. Recent QOL initiatives by the Secretary of Defense will help Army maintain that growth by directing additional funds toward Army MWR program support. This increase will enable commanders to sustain quality programs and services at rates affordable by soldiers and families, while at the same time minimizing surcharges to soldiers and reducing NAF support to APF missions.

Nonappropriated Funds (NAF): NAF is earned from sales of goods and fees for services provided by the Army and Air Force Exchange Service (AAFES), including their retail operations, sales of name brand fast food, pay telephones, and Class Six packaged beverage operations. Other sources of NAF include resale, fees, and charges from the business programs (clubs, bowling, and golf), revenues generated within Community Support programs, and receipts from the Army Recreation Machine Program (ARMP). Total NAF revenue was \$930 million in FY 94.

AAFES Dividends: The AAFES Board of Director's policy for determining profit distribution recognizes equal sharing between the Services and AAFES. The Services' half is divided between the Army and Air Force based on average troop strength while AAFES retains 50 percent for capitalization requirements. In recent years, several joint MWR/AAFES initiatives have resulted in the Services receiving additional revenues beyond the traditional 50/50 dividend split. Examples include pay telephone concessions and Class Six packaged beverage operations. The Army has directed that AAFES distribute these dividends locally as they were traditionally part of installation MWR operations. It is called the Army Simplified Dividend. The Army's central fund, the Army MWR Fund (AMWRF), is the recipient of the traditional AAFES dividend. The dividend directed to the AMWRF is dedicated to support operating program and capital investment strategies. Major uses of cash include funding NAF major construction projects, Army-wide training, and centralized installation support services.

Revenue Generating Programs: Charges for programs and services represent the third element of the NAF funding triad. For FY 1994, major contributors included golf, guest houses, leisure travel, and recycling. The fees and charges generated from these programs more than covered their own operating expenses with the surpluses supporting other community programs such as youth activities and unit level sports.

Army Recreation Machine Program (ARMP): Operational since 1981, ARMP operates 4,736 machines at 283 locations in 7 countries overseas, generating a significant financial benefit to the Army. The machines return, on average, 93.5 percent to the customer. Annual audit reports by a commercial accounting firm credentialed in the gaming industry cited the internal control system as the most stringent in that industry. Current Army policy dictates that 40 percent of slot machine income is retained at the departmental level to fund major construction. Since 1981, the Army

spent or obligated over \$350 million on MWR capital improvements. These projects include the construction of Dragon Hill Lodge, the redevelopment of Fort DeRussy, MWR infrastructure of nine facilities at Fort Drum, and the rehabilitation of the downsized AFRC-Europe. The program also provided the financial wherewithal for millions more in installation capital projects.

Army-wide Cash Consolidation: Since September of 1991 and prior to the cash sweep, in response to an aggressive capital reinvestment program with strong leadership emphasis on execution of the capital purchase minor construction (CPMC) program, field operating cash balances declined by 50 percent. Then, in response to the FY 95 Defense Authorization Bill, the Army implemented a "sweep" of excess cash from Army installations as of 31 October 1994 financial data. All cash, less change funds, petty cash funds, and funds already obligated for fixed assets, in excess of a 2 to 1 cash to debt (total liabilities) ratio, was swept from installations into the Army MWR Fund. Approximately \$72 million cash was centralized in the Army MWR Fund. This cash will be used to fund Army-wide requirements, primarily capital investment. To continue compliance with the intent of Congress that monies be consolidated at the Service level, Army instituted a Capital Reinvestment Assessment on all installations of 2 percent of total revenue in 1996, increasing to 3 percent in 1997 and beyond. This assessment will provide centralized funds for Army-wide requirements on a universally applicable basis. To ensure the accuracy of our procedures, we requested a complete audit by the U.S. Army Audit Agency.

Army Banking and Investment Fund (ABIF): The ABIF is the Army's cash management system that consolidates, invests, and safeguards the cash assets of Army NAFI's worldwide. On behalf of over 400 NAF Activities, the ABIF invests in short-term Treasury securities and debt of government agencies. Depositors may be characterized as: Non-discretionary, NAFI's dedicated for a special purpose; DOD/Joint Service NAFI's, separate transient lodging funds, and operating funds. Historically, participants in the ABIF earned interest rates higher than those available through commercial institutions. During FY 94, participants earned a compounded rate of 3.99 percent on their average deposits. In FY 95 we expect the return to be somewhat higher, despite not earning any interest on one government derivative investment. We took assertive steps to review our practices and policies. Oversight has been strengthened. All investments possess the implicit or explicit full faith and credit of the U.S. Government against default. An audit of this fund and all other headquarters funds is performed annually by a certified public accounting firm.

CAPITAL REINVESTMENT

Two major uses of cash are facilities construction and personnel development.

Facilities Construction: The Army constructs facilities using methods which ensure timeliness, high quality, energy efficiency, and cost effectiveness. Since our facilities are comparable to those found in the municipalities, the Army relies heavily on commercial industry building standards and the experience of private construction firms.

The Army's MWR construction program is developed through a comprehensive review and screening process which selects, from an Army perspective, only the highest priority projects. Private industry consultants are contracted to conduct market research which assesses the need for each project and determines facility size and its ability to provide long-term return on investment.

In the past fourteen years, Congress approved approximately \$1.6 billion worth of MWR facilities. Of this amount, over 70 percent was paid with nonappropriated funds. The appropriated funds used for MWR projects paid for child development centers, libraries, and physical fitness centers. Based on cash flow projections, the Army construction program is expected to remain steady at approximately \$35 million per year, out to the year 2000.

MWR Workforce: With a quality MWR workforce we can deliver effective programs. Accordingly, we must continue to develop, improve, and adapt programs and systems that will improve management and retain quality employees in our diverse workforce. Army MWR employs a workforce of 36,850 employees: 6,420 are appropriated fund employees and 30,430 are nonappropriated employees.

The Army continues its strong commitment to training. Additionally, we manage our own training center which has trained over 6,500 managers since its establishment in 1987. Our Master Training Plan includes a mandatory three-week basic management course and training for every level of management up through executive and senior positions. The Army recently developed an MWR management orientation for Installation (General Officer) and Garrison (Colonel) commanders. Both courses are being very well received by all attendees.

INITIATIVES

The Army MWR Strategic Action Plan details initiatives and strategies designed to realize efficient provision of quality programs. Army commanders responded to these initiatives, and strong positive momentum was established. Among these initiatives are:

Army MWR Financial Standards: For the first time in MWR history, the Army instituted comprehensive financial assessment standards for MWR programs, effective FY 94. These standards have been further tightened and require that:

- a. Installation MWR Funds create monies for local reinvestment at a rate of 5 percent per year.
- b. Installation MWR funds maintain a cash to debt ratio of between 1:1 and 2:1.
- c. Category A programs receive maximum APF support.
- d. Category B programs collectively at least break-even (NAF).

- e. Category C programs individually at least break-even.
- f. NAF subsidies to child care not exceed \$200 per child care space.
- g. Installations complete at least 70% of budgeted capital investment.

The financial standards are a very real success story. As a direct consequence of the heightened leadership focus, Army clubs reversed a losing trend, finishing in the black in FY 94. Total overhead was reduced twelve percent. The NAF subsidy for child development services was reduced from a high of \$709 to \$212 per child care space, far exceeding the goal of \$400. In the aggregate, this represented a \$12.7 million turn around.

Standardization and Consolidation Acquisition Program: The Army instituted the Standardization and Consolidation Acquisition Program which was formulated in conjunction with a Memorandum of Agreement (MOA) signed with the Air Force in August 1994. The MOA enables the Army and Air Force to capitalize on consolidated buys, increase negotiation leverage, and promote acquisition planning by establishing a Purchase Review Board (PRB) to select supplies and services that are good candidates for standardization and consolidation. The PRB process keeps MACOMs and installations actively involved in the program, provides a medium for continuous interface with installations, results in cost savings to MWR, and meets the goal of superior customer service.

Clubs: Army leadership shares Congressional concern over the viability of Army Clubs. They continue to show improvement in financial performance and their ability to provide demand-driven programs for soldiers and their families. This year, clubs earned net income before depreciation (NIBD) of \$2.5 million, compared to FY 93 NIBD of \$0.2 million. The NIBD has been adjusted to exclude base closure costs of \$3.1 million in FY 93 and \$2.1 million in FY 94. The \$2.3 million club turnaround was caused by continuing management efforts to reduce costs, improve food quality and service, and provide demand-driven programs. This turnaround is even more dramatic when we consider that total revenue during the period decreased \$12.6 million.

Food, Beverage and Entertainment Assessments: Army-wide, food and beverage sales represent 25 percent of MWR revenue. A major initiative to improve food, beverage and entertainment programs (FB&E) and meet market demands involves the conducting of FB&E assessments at selected Army installations. These assessments are a cooperative effort between MWR and AAFES. The goal is to identify the installation's key market opportunities for FB&E services (to include AAFES), suggest a restructuring of the current FB&E services to capitalize on these opportunities, and develop a realistic plan for implementing the required changes. Results from assessments conducted to date have been exceptional. There is currently a joint services study to assess the FB&E operations of the Army, Navy and Marine Corps installations on the island of Oahu, Hawaii.

We will continue to offer traditional club programs where there is a market demand. However, the FB&E assessments identified the need to offer market-driven programs such as theme restaurants, social lounges and high-energy nightclubs, and sports bars. CFSC developed a variety of theme concepts patterned after nationally recognized casual and family style civilian sector restaurants. The concepts include offerings ranging from an Italian family-style restaurant, to the ultimate interactive sports recreation facility featuring big screen TV's with continuous broadcasts of live sporting events. The goal is to provide the soldier with the FB&E activities that respond to demand.

Shades of Green (AFRC-Orlando): Shades of Green on Walt Disney World Resort in Orlando, Florida, completed its first year of operation in February 1995. With annual occupancy of 94 percent, twice as many junior enlisted guests as anticipated, and reservations for the next year already at 61 percent, the first Armed Forces Recreation Center (AFRC) in the continental United States is an unqualified success with soldiers and families. Financial performance did not meet expectations as yet, primarily due to the higher than estimated use by junior enlisted personnel in the lowest tiers of our pricing structure. This "soldier success story" makes the long-term forecast for Shades of Green financially tenuous due to the operating expense of building and land rent, which no other AFRC must pay. No appropriated funds have been, or will be, used in Shades of Green. The Army is actively considering exercising the option in the existing lease to purchase the building and pre-pay the land rent for the entire term of the lease. To ensure that we make a sound management decision, the Army is conducting an affordability analysis from an independent accounting firm. Upon completion of their work, the results will be briefed through all appropriate levels. Should the results support an Army decision to pursue this investment we will need the Panel's expeditious consideration and support as the negotiated offer from the landlord expires September 28, 1995.

Hale Koa/Fort DeRussy: Construction of a new hotel tower and re-development of Fort DeRussy, Hawaii is scheduled for completion in late summer, 1995. This NAF project culminates the Congressionally approved Army plan of 1988 to transform Fort DeRussy into the Armed Forces Recreation Center for the Pacific Rim. The Morale, Welfare, and Recreation (MWR) Panel and the Senate Armed Services Committee monitored this project closely since approval. This long-awaited project--the largest service-funded NAF construction project in history--will not only add 396 new rooms to the resort destination with the highest occupancy rate in the world, but will also provide needed revenues to ensure the economic viability of all Army AFRCs.

Armed Forces Recreation Center - Europe (AFRC-E): The AFRC-E originally consisted of facilities in the towns of Garmisch and Berchtesgaden, and at Lake Chiemsee, in Germany. In 1991, the Secretary of the Army and Congress approved a plan for the future which created an end-state of four hotel facilities in Garmisch and Chiemsee. In 1993, the German government offered to pay for renovations to two hotels in Berchtesgaden in exchange for the Army returning the facilities at Chiemsee to German control. Army and the Congress accepted that proposal, on the condition that a formal agreement could be reached and no Army investment would be required

at Berchtesgaden. Facilities at Chiemsee were inactivated in September 1994. In January 1995, the German government withdrew the offer of funding. The Army plan is to re-open facilities at Chiemsee this summer, and cease operations at Berchtesgaden by the end of this year, thus achieving the previously approved end-state for AFRC-E.

In response to Congressional concerns, the Army reduced appropriated fund (APF) support to AFRC-E from \$17.8 million in FY 91 to a budgeted \$4.0 million in FY 95. All APF civilian positions were cut from the staff as of September 30, 1994. Despite these severe reductions, AFRC-E operations achieved a positive NIBD in FY 94 and project a positive NIBD in FY 95. A Department of Defense Inspector General report in February of 1994 criticized the use of certain APF support of AFRC-E during 1991. The Office of the Assistant Secretary of the Army for Financial Management subsequently verified that no unauthorized uses had occurred and that proper controls are currently in place. Their review also confirmed the need for continued AFRC operations to support the end state force in Europe.

Hotel Thayer: On January 3, 1995, pursuant to Congressional guidance received from the MWR Panel, House Armed Services Committee and the Senate Armed Services Committee, CFSC gave the selected developer conditional notice of award. The developer now has 120 days to display his ability to provide all necessary financing for the hotel's renovation and expansion. If the developer meets all the requirements of the request for proposal (RFP), as determined by the contracting officer, final award of the contract will be made on May 3, 1995. The Army is seeking clarification of previous MWR Panel guidance to limit Army expenditure of nonappropriated funds (NAF) for this project to \$25 million. The private developer will renovate, expand, and operate using credit enhanced private financing. The Army does not believe the \$25 million limit should apply to future options to buy or sell the hotel. We need your support to quickly resolve this issue.

Amusement Games: In August 1992, the Community and Family Support Center (CFSC) evaluated the feasibility of providing amusement game operations, e.g. video games, pool, etc. to Fort Sill, Oklahoma. The results indicated CFSC could operate a program entirely funded with NAF at selected installations, incorporating strong internal control practices, providing state-of-the-art amusement games, and dedicated repair and maintenance service in a manner which significantly improved revenues to the installation. In September 1994, a Memorandum of Understanding was signed by AAFES and CFSC to also directly operate amusement games in selected AAFES locations. In addition to Fort Sill, CFSC established operations at Fort Lewis, Washington; Fort Irwin, California; and Fort Benning, Georgia. Operations are scheduled to begin in Eighth U.S. Army in Korea in June 1995, and proposals have been made to Fort Jackson, South Carolina; Fort Gordon, Georgia; Fort Bragg, North Carolina; and the United States Marine Corps Air Station, Iwakuni, Japan.

Army Entertainment: The Concert Series is a large scale, professional entertainment, outdoor concert tour that provides high quality, top name professional entertainment to installations across the continental United States. It is entrepreneurial and centrally

funded, providing great potential revenue for installation MWR funds which, in return, may provide staffing, equipment and resources for scheduling future soldier entertainment events, or other MWR activities. The series also provides installations with the ability to meet the demand of providing high quality professional entertainment at a reasonable price for soldiers, Department of Defense employees, and their family members.

Army Recreation: The 21st Century Army Recreation delivery system will be customer-driven with emphasis on soldiers, deployment, and implementing the civilian brigade recreation specialist concept. The shifting emphasis is from facility-bound recreation to a service based system. Evolution is the key to this approach since customers will determine services provided. The foundation for the new delivery system is that the program is not facility-bound. It is market-driven, and focuses on soldier readiness during deployments and at home installations. The streamlined management structure will produce cost savings in future construction and operational costs in utilities, supplies, equipment, facility maintenance, and personnel. The new delivery system will employ brigade recreation specialists and recreation programmers to serve as unit coordinators. In that capacity, they will assist commanders in assessing unit/soldier needs and integrating these requirements into providing greater day-to-day interaction with units, individuals, and commanders in order to satisfy the needs of America's Army.

BOSS Program: BOSS is the acronym for Better Opportunities for Single Soldiers. The program was started in 1989 to address the MWR needs and to expand recreational program opportunities for single soldiers. In 1990 the Chief of Staff, Army, expanded the program into every aspect of the soldier's life. BOSS provides a vehicle for input and feedback between the single soldier and unaccompanied soldier, the installation staff, and the command. Today the program is implemented at all installations with single soldier populations greater than 50. Many installations have full-time staff devoted to the BOSS program. A few of their responsibilities include involvement in: newcomer briefings, follow-up on BOSS issues such as work orders, participation on installation councils such as Army and Air Force Exchange (AAFES), commissary, barracks, health promotion and other councils. The BOSS program is heavily involved in community service and volunteerism. The BOSS soldiers at Fort Benning built a house for Habitat for Humanity in one week; Fort Myer BOSS program routinely sends care packages to deployed soldiers; numerous installations have Big Brother-Big Sister programs and regularly tutor or mentor young children. Installation BOSS programs often assist with Special Olympics and numerous other programs.

Children and Youth Programs: The Army provides child care options designed to reduce the conflict between soldiers' parental responsibilities and their on the job mission requirements. This program is an Army "success story" because of the tremendous strides made in improving the quality of care, increasing the availability of care and maintaining affordable fees for our working families. Eighty- five of our child development centers are now nationally accredited -- a national benchmark of quality; each installation has an individualized child care availability plan which outlines how they will use a variety of local on and off post sources of care to meet DOD child care

goals. We reduced our NAF child care subsidy by 72 percent in the last year, while at the same time instituting a special lower fee for families earning less than \$19,000 annually. We are reviewing youth programs to address current needs including out-of-school options during parental duty hours and to counter the increasing at risk behaviors found not only in our youth but also throughout society. We are piloting cooperative initiatives which target MWR activities and facilities as prime providers of before and after school programs. We are expanding beyond traditional sports and recreation activities to teach employment and life skills, offer opportunities for community service and leadership, address teen health and nutrition issues, and provide support such as homework centers and counseling services. We believe it will take the whole military community to achieve this ambitious undertaking and we are forming installation and off post partnerships to best utilize our existing resources.

Army Family Team Building (AFTB): The Army implemented a new initiative called Army Family Team Building (AFTB). AFTB is a sequential, progressive, training program using primarily volunteers and some paid staff to train active, Reserve Component soldiers, civilians, and family members on those skills that promote self-reliance; promote an understanding of Army institutions and services; and contribute to a successful Army family. The program contributes to overall readiness and is particularly valuable during deployments because Army families are stronger in every regard.

Army Community Service (ACS) Restructuring: ACS provides programs and services to address frequent unit deployments and contingency operations and soldiers' time away from home station. Emphasis is to be proactive to ensure the readiness of the individual, family, and community before mobilization and deployment. ACS embarked on a major restructuring based on customer surveys and family research. This new strategic plan recognizes commanders as the primary customer, with ACS providing assistance in maintaining readiness of individuals, families, and communities. The plan establishes a paradigm shift to prevention, training and education, and information and referral services. ACS is reorienting services to military units while maintaining a core staff in ACS Centers. Mobilization and deployment assistance will continue to be emphasized.

Army Family Action Plan (AFAP): AFAP is a tremendous grass-roots program to resolve quality of life issues. It is a continuing success story. AFAP is a bottom-up review of all programs throughout the force and serves as a decision-making tool for Army leadership. It offers members of America's Army a mechanism through which they can express their quality of life concerns, be heard, and make a difference. Since the first AFAP conference in 1983, 263 issues have been resolved, resulting in 38 pieces of legislation, 95 new or revised policies, and 98 new or improved programs or services. Top issues center around entitlements such as pay, housing, and education; and medical issues.

CONCLUSION

Army leadership has stated, "Part of the success of the All-Volunteer Force has been our ability to retain quality soldiers, and we have been able to do that because of the commitment of the Congress to providing the resources to maintain the quality of life for soldiers and their families." When sufficiently funded and staunchly supported, quality of life programs do make a difference. According to the Spring 1994 Sample Survey of Military Personnel (SSMP), almost three-fourths of soldiers think their families adjusted "well" to "very well" to the demands of being an Army family. The survey further reveals soldier satisfaction is high for youth services, recreation services, quality and availability of Army family programs, and overall quality of Army life. These statistics confirm that the Army is headed in the right direction.

The Army, however, recognizes there is always room for improvement. Congress directed MWR programs to operate in a more business-like manner with greater emphasis on the bottom line. The Army embraced numerous initiatives to promote more fiscally successful policies and practices. MWR is focusing more intensely on America's Army as our customer, and providing demand-driven programs that support readiness while responding to a changing resource environment. In that context, the Army remains firmly committed to providing a quality of life for soldiers and their families commensurate with that of the communities of the nation they are pledged to defend. We welcome your interest in, and request your continued support for, Army MWR programs.

Mr. McHUGH. Thank you.

We will next recognize Rear Adm. Larry Marsh. Welcome.

STATEMENT OF REAR ADM. LARRY R. MARSH, ASSISTANT CHIEF OF NAVAL PERSONNEL, READINESS & COMMUNITY SUPPORT, BUREAU OF NAVAL PERSONNEL, U.S. NAVY

Admiral MARSH. Thank you, Mr. Chairman. It is indeed a pleasure for me to be here as well, and to appear before this MWR Oversight Panel with my colleagues. I also have submitted a detailed statement for the record and I appreciate this opportunity to now summarize it and our current status and future strategy for dealing with a smaller force as we, in the Navy, approach our long-term projected steady state force levels which we intend to reach in fiscal year 1999.

The Navy MWR is geared toward improving readiness and maintaining retention levels for career personnel through personal and community support in the form of physical fitness, recreation, entertainment, and organized leisure opportunities for our active duty personnel and their dependents. Unlike most functions in the Navy, MWR is expected to generate profits from some retail activities to cover part of the cost of doing business.

The Navy, over the last several years, has sought to strike a balance between adequate levels of appropriated fund support, adequate profits from revenue-generating operations such as clubs, golf courses, and bowling, and recapitalization of the MWR structure using Navy exchange profit dividends. I am happy to report that we are seeing results from all these efforts.

In keeping with our overall strategy, we have implemented an active program to reduce the MWR infrastructure and program scope in keeping with our overall Navy reductions and our patron needs. Additionally, we are focusing our attention on core programs that have wide appeal such as fitness and outdoor recreation. Finally, we are committed to recapitalization as the key to protecting our revenue-generating capacity well into the future.

During 1994, the Navy witnessed a major positive shift in appropriated funds support per capita. We now fund three-fourths of the mission-essential programs with appropriated funds. This has freed up money, particularly at the station level, to effect long-needed repairs and renovations. I am also pleased to report today that nonappropriated central fund levels are stable and are earning an excellent return, thus helping to defray overhead costs from our field activities.

We have also thoroughly reviewed our investment strategy and portfolio to ensure that we do not have unwanted risk. I am happy to say that we do not. The Navy has been very careful to guard against the buildup of funds beyond our actual cash needs as well. In 1994, we ended the year with just \$10.4 million in surplus which will be fully committed to capitalization and our program subsidy for this year.

Although 1994 and 1995 were relatively lean years for central capitalization, cost-containment initiatives and needs-based budgeting have shown effectiveness in reducing our outyear subsidy requirements. This will allow a much larger portion of Navy exchange profits to fund major capital requirements.

By way of oversight, we have instituted standards and controls to incentivize more business-like behavior of our station level MWR operations. Rigorous budget reviews which link appropriated funds support with nonappropriated fund sources have yielded dramatic economies. Management assistant teams at BRAC bases and underperforming bases have also been especially effective.

Core programs identified by our Navy leadership and patron base are being broken down into representative standards and matrix to compare our individual bases by type and location. This effort will greatly aid in resourcing decisions and ensuring equitable support for all of our sailors.

Mr. Chairman, we are moving out aggressively in pursuit of our strategy to size MWR programs to the needs of our patrons, and the Navy to recapitalize where necessary. We will need your ongoing support for our forthcoming APF funding request. For our part, we will continue to streamline the way we operate, building on MWR program strengths, and improving areas of weakness.

Again, thank you for the opportunity to appear before you today and to discuss the Navy MWR. I stand ready to answer any of your questions.

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COMMITTEE

STATEMENT OF
REAR ADMIRAL LARRY R. MARSH, U. S. NAVY
ASSISTANT CHIEF OF NAVAL PERSONNEL
FOR PERSONAL READINESS AND COMMUNITY SUPPORT
BEFORE THE
HOUSE NATIONAL SECURITY COMMITTEE
SPECIAL OVERSIGHT PANEL ON
MORALE, WELFARE AND RECREATION
29 MARCH 1995

NOT FOR PUBLICATION UNTIL
RELEASED BY THE HOUSE
NATIONAL SECURITY COMMITTEE

STATEMENT FOR THE RECORD
FOR THE U. S. NAVY
MORALE, WELFARE AND RECREATION (MWR) PROGRAMS

MR. CHAIRMAN, MEMBERS OF THE SUBCOMMITTEE, THANK YOU FOR THIS OPPORTUNITY TO DISCUSS WITH YOU THE NAVY'S MWR PROGRAM. MY REMARKS WILL PROVIDE DETAILS ON MWR'S CURRENT FINANCIAL AND PROGRAMMATIC STATUS AND FUTURE STRATEGY IN TRANSFORMING OUR PROGRAMS TO MEET THE NEEDS OF THE SMALLER FORCE THAT WE ARE SERVING.

BACKGROUND

OUR MWR PROGRAMS PROVIDE OUR SAILORS AND THEIR FAMILIES WITH THE CIVILIAN EQUIVALENT OF COMMUNITY RECREATION SUPPORT AND PHYSICAL FITNESS PROGRAMS, AS WELL AS A VARIETY OF FOOD AND BEVERAGE SERVICES. THESE PROGRAMS INCLUDE A WIDE RANGE OF LEISURE, FAMILY SUPPORT AND PERSONAL DEVELOPMENT ACTIVITIES TO MEET THE NEEDS OF OUR ENTIRE NAVY FAMILY.

THE NAVY'S MORALE, WELFARE AND RECREATION PROGRAM HAS BEEN AND WILL CONTINUE TO BE CRITICAL TO OUR SUCCESS IN MAINTAINING A READY FORCE TO DEFEND OUR NATION. SATISFACTION WITH THE QUALITY OF MWR PROGRAMS, SERVICES AND FACILITIES IS A KEY FACTOR IN A SAILOR'S DECISION TO REENLIST. SURVEYS CONFIRM THAT THERE IS A STRONG CORRELATION BETWEEN THE QUALITY OF LIFE SUPPORT MWR PROVIDES AND THE NAVY'S SUCCESS IN RETAINING A QUALITY FORCE. A RECENT SURVEY RELEASED BY BUPERS SAID THE NUMBER 1 REASON SAILORS

STAY IN THE NAVY IS SUPPORT/RECREATION SERVICES. MWR'S PRINCIPAL MISSION IS TO PROVIDE BASIC PHYSICAL FITNESS NEEDS AND A VARIED PROGRAM OF WHOLESOME AND CONSTRUCTIVE OFF-DUTY RECREATION AND LEISURE OPPORTUNITIES FOR SAILORS AND THEIR FAMILIES -- ALL OF WHICH EFFECTIVELY CONTRIBUTE TO THEIR MENTAL, PHYSICAL AND SOCIAL WELLBEING. MWR PROVIDES MISSION ESSENTIAL FUNCTIONS WHICH ENHANCE READINESS BY PROMOTING TEAM WORK, RETENTION, FITNESS, A POSITIVE MENTAL OUTLOOK, IMPROVED MORALE, AND A HEALTHY ALTERNATIVE TO SUBSTANCE ABUSE.

SEVERAL FACTORS HAVE HAD A SIGNIFICANT INFLUENCE OVER THE DIRECTION AND SCOPE OF OUR MWR PROGRAM. FIRST, THE MWR ACTIVE DUTY PATRON BASE HAS DECLINED SIGNIFICANTLY OVER THE PAST SEVERAL YEARS AND WILL CONTINUE TO GET SMALLER AS THE NAVY APPROACHES THE STEADY STATE FORCE LEVEL OF FY99. THE NAVY'S OVERALL INFRASTRUCTURE IS ALSO GETTING SMALLER. WE NOW HAVE THE COMPLETE BASE CLOSURE PICTURE AS FORWARDED BY THE SECRETARY OF DEFENSE TO THE BASE CLOSURE COMMISSION. ALTHOUGH STILL PRELIMINARY, THIS INFORMATION WILL ALLOW US TO MOVE OUT ON RECAPITALIZATION INITIATIVES AT NAVY COMMANDS NOT IMPACTED BY BASE CLOSURE OR REALIGNMENT.

EQUALLY IMPORTANT IS THE HIGH LEVEL OF OPERATING TEMPO THE NAVY HAS RECENTLY EXPERIENCED. THIS FASTER PACE OF OPERATIONS MEANS INCREASED STRESS ON OUR SAILORS AND THEIR FAMILIES WHICH MAKES MWR SUPPORT MORE VITAL THAN EVER BEFORE. MWR'S IMPORTANCE

TO THE OVERALL READINESS PICTURE WILL CONTINUE TO GROW AS WE STRIVE TO RETAIN THE HIGH QUALITY SAILORS NEEDED IN A SMALLER FORCE.

DECLINING RESOURCES HAVE IMPACTED OUR ABILITY TO MEET ALL THE REQUIREMENTS. THIS SITUATION HAS BEEN EXACERBATED BY THE DECREASING PATRON BASE USING THE NAVY EXCHANGE. NAVY EXCHANGE REVENUES ARE DECLINING CONSISTENT WITH THE PATRON BASE, RESULTING IN A MUCH SMALLER NONAPPROPRIATED FUND (NAF) STREAM TO HELP SUPPORT MWR PROGRAMS. AS A RESULT, IT IS NECESSARY TO EMPLOY A STRATEGY THAT ACHIEVES A BALANCED SHARE OF APPROPRIATED FUNDS FOR MWR MISSION ESSENTIAL FUNCTIONS AND AT THE SAME TIME MAKES MWR MORE EFFICIENT.

MWR ORGANIZATIONAL STRUCTURE

THE STRENGTH OF NAVY MWR RESTS ON DECENTRALIZED OPERATIONAL CONTROL AND PROGRAM EXECUTION BY COMMANDING OFFICERS, WHICH ENSURES OPTIMAL RESPONSE TO LOCAL LEVEL PATRON AND COMMAND NEEDS. TO SUPPORT THIS DECENTRALIZED SYSTEM, NAVY HAS CREATED COMPREHENSIVE PROGRAM OVERSIGHT AND SUPPORT SYSTEMS.

OUR COMMANDING OFFICERS ARE RESPONSIBLE FOR DAY TO DAY OPERATIONAL CONTROL OF THEIR MWR PROGRAM, WHICH PROVIDES THE FLEXIBILITY NEEDED TO MANAGE RESOURCES AND ADJUST PROGRAMS IN RESPONSE TO PATRON DEMAND. THE MWR SYSTEM IS BROUGHT TOGETHER AT

THE TOP BY A HIGH LEVEL BOARD OF DIRECTORS. THIS BOARD MAKES ALL MAJOR BUSINESS AND POLICY DECISIONS FOR BOTH MWR AND NAVY EXCHANGE PROGRAMS AND PROVIDES OVERSIGHT FOR OF THEIR OPERATIONS.

OUR DECENTRALIZED SYSTEM HAS PROVEN EFFECTIVE OVER THE YEARS. PROGRAM SATISFACTION LEVELS ARE HIGH. COMMANDING OFFICERS HAVE BEEN INNOVATIVE AND JUDICIOUS IN ADJUSTING MWR PROGRAMS AS PATRON NEEDS AND WANTS CHANGE.

STRATEGIES TO MEET THE FUTURE

HAVING PROVIDED YOU WITH SOME BACKGROUND REGARDING ORGANIZATIONAL STRUCTURE AND ISSUES, I'D LIKE TO DISCUSS OUR OVERALL STRATEGY FOR SHAPING THE FUTURE OF MWR. TO SUCCEED MWR MUST:

- GET SMALLER JUST LIKE THE REST OF THE NAVY. HOWEVER, WE MUST FOCUS ON REDUCING OVERHEAD EXPENSES BEFORE CUTTING PROGRAMS.

- GET SMARTER ABOUT OUR OPERATIONS AND OUR PATRONS. WE NEED TO KNOW WHAT OUR PATRONS WANT AND RESPOND WITH APPROPRIATELY TAILORED PROGRAMS.

- STAY FOCUSED - OUR PRIMARY JOB IS TO TAKE CARE OF THE CORE PROGRAM NEEDS OF OUR SAILORS AND THEIR FAMILIES - WE CAN'T AFFORD

TO BE ALL THINGS TO ALL PEOPLE.

- STRIVE TO GET BETTER EQUIPPED AND CAPITALIZED - WE MUST TAKE EVERY OPPORTUNITY TO ADEQUATELY RECAPITALIZE OUR FACILITIES.

APPROPRIATED FUND (APF) SUPPORT

OVER THE PAST SEVERAL YEARS THE NAVY HAS CONSISTENTLY RELIED MORE HEAVILY ON NAF THAN APF TO FUND ITS MISSION ESSENTIAL PROGRAMS. THIS BURDEN HAS STRAINED OUR NAF RESOURCES AND RESULTED IN A WEAK RECAPITALIZATION EFFORT.

WE BEGAN TO CHANGE THAT STRATEGY IN FY-94 WITH THE APF PLUS-UP THE CHIEF OF NAVAL OPERATIONS (CNO) AUTHORIZED FOR MWR. IN ADDITION, RECENT CNO DIRECTION TO ENHANCE MWR STANDARDS WILL ENABLE US TO SIZE THE REAL PROGRAM NEEDS OF MWR BASED ON PATRON DEMAND AND MARKET/PROGRAM DRIVEN PRIORITIES. THIS NEW DIRECTION WILL ENSURE THAT WE SPEND OUR APF IN THE MOST COST EFFECTIVE MANNER POSSIBLE.

THE NAVY'S FY-94 APF OPERATION AND MAINTENANCE (O&M,N) SUPPORT FOR MWR WAS \$311 MILLION FOR BOTH DIRECT AND INDIRECT EXPENSES. THE FY96 O&M,N FUNDING LEVEL FOR MWR SHOWS A \$2 MILLION REDUCTION FROM FY-95, REFLECTING THE EFFECTS OF FY96 BASE CLOSURES. THE PLUS-UP IN FY-94 O&M,N SUPPORT TO MWR PERMITTED FUNDING OF CRITICAL MAINTENANCE AND REPAIR DEFICIENCIES, AND

NEEDED EQUIPMENT PURCHASES. IT ALSO RELEASED FUNDING FOR NAF PROJECTS TO REDUCE LOCAL CONSTRUCTION BACKLOGS.

DESPITE THE PLUS-UP, WE ARE STILL ONLY FUNDING 76% OF AUTHORIZED MISSION ESSENTIAL PROGRAM COSTS AND 53% OF COMMUNITY SUPPORT PROGRAM COSTS WHICH INCLUDE YOUTH PROGRAMS AND CHILD CARE.

CHILD CARE HAS FARED WELL IN THE ALLOCATION OF APPROPRIATED FUNDS SINCE THE PASSAGE OF THE MILITARY CHILD CARE ACT OF 1989. WE NEED TO CONTINUE TO LOOK AT THE BEST WAY TO PROVIDE CHILD CARE TO AS BROAD A GROUP AS POSSIBLE AT A REASONABLE COST BOTH TO PARENTS AND THE GOVERNMENT. TO AUGMENT SPACES IN CHILD DEVELOPMENT PROGRAMS THE FY-96 O&M,N FUNDING FOR CHILD CARE INCLUDED FUNDS TO CONTINUE THE COMMERCIAL OUTSOURCING TEST DIRECTED BY CONGRESS IN THE FY-95 AUTHORIZATION BILL. THE OBJECTIVE OF THIS TEST IS TO DETERMINE THE FEASIBILITY OF DEVELOPING OFF-BASE CHILD CARE SOURCES BY BUYING DOWN RATES AND ENCOURAGING THE PRIVATE SECTOR TO GEAR UP TO MEET THE DEMAND. WE ARE ALSO BUILDING A TEST PROGRAM TO SUBSIDIZE RATES IN FAMILY CHILD CARE (NAVY HOME BASED CARE), PROVIDING AN ADDITIONAL HIGHLY FLEXIBLE, LESS EXPENSIVE METHOD TO DELIVER QUALITY CARE.

NAVY APF INITIATIVES OVER THE NEXT FEW YEARS WILL FOCUS ON THE FOUR EFFORTS I JUST DESCRIBED: OBTAINING FULL FUNDING FOR AUTHORIZED APF EXPENSES FOR MISSION ESSENTIAL FUNCTIONS, INCLUDING NECESSARY CONSTRUCTION FUNDING FOR FITNESS PROGRAMS;

FUNDING RECREATION AND FITNESS EQUIPMENT FOR SHIPBOARD SAILORS; FUNDING EXPANDED CHILD CARE OUTSOURCING AND A COST EFFECTIVE FAMILY CHILD CARE SUBSIDY PROGRAM; AND SEEKING THE NEEDED FLEXIBILITY TO MAXIMIZE EXECUTION OF APF SUPPORT FOR MWR PROGRAMS.

BECAUSE MWR PROGRAMS CLEARLY HAVE A DECIDED INFLUENCE ON READINESS, MWR TODAY IS BOTH A RECOGNIZED READINESS COST AND AN INVESTMENT IN MAINTAINING THE QUALITY OF OUR FORCE INTO THE FUTURE.

NAF FINANCIAL CONDITIONS

THE HEALTH OF MWR NAF HAS IMPROVED. WE ENDED FY94 WITH A \$10.2 MILLION SURPLUS FOR REINVESTMENT IN FIELD CAPITALIZATION NEEDS, AN OVERALL IMPROVEMENT OF \$42 MILLION FROM FY-93. THE TURNAROUND WAS DUE TO THE EFFECT OF THE APF PLUS-UP AND TO INTERNAL COST EFFICIENCY ACTIONS TO ALIGN NAF EXPENSES WITH DECLINING REVENUES. WITH THE APF PLUS-UP, WE WERE ABLE TO RESTART A NAF MAJOR CONSTRUCTION PROGRAM, AND SUPPORT LOCAL CAPITAL SPENDING EFFORTS.

THE TREND THUS FAR IN FY-95 SHOWS THAT THE FY94 TURNAROUND HAS BEEN SUSTAINED. OUR PROGRAM IS OPERATING IN THE BLACK THROUGH JANUARY 1995. DESPITE A PROJECTED REVENUE DECLINE OF 3 PERCENT IN FY-95, WE EXPECT OVERALL SYSTEM NAF PROFITABILITY AND

CAPITAL SPENDING TO IMPROVE OVER THE FY-94 LEVEL.

NAVY MWR CASH BALANCES ARE NOT EXCESSIVE. MWR CASH RESOURCES ARE SUFFICIENT TO MEET CURRENT LIABILITIES, AND FUND PREVIOUSLY APPROVED CAPITAL PROJECTS. WE TOOK POSITIVE STEPS IN 1993 TO CONSOLIDATE UNUSED NAF CASH AND PUT IT TO WORK ON HIGH RETURN CAPITAL PROJECTS.

WE HAVE AN ESTABLISHED SYSTEM OF FINANCIAL CONTROLS TO MONITOR NAF RESOURCES. WE IMPLEMENTED A "RED FLAG" EARLY WARNING SYSTEM IN 1993 TO ALERT INSTALLATION COMMANDING OFFICERS WELL BEFORE THEY WERE IN FINANCIAL EXTREMIS. WITH INCREASED ATTENTION BY THE NAVY CHAIN OF COMMAND, AND USE OF RECENTLY FORMED MANAGEMENT ASSISTANCE TEAMS, THE NUMBER OF FUNCTIONALLY INSOLVENT INSTALLATIONS HAS DROPPED BY HALF IN RECENT MONTHS. ADDITIONALLY, WE HAVE IMPLEMENTED A RIGOROUS BUDGET DISCIPLINE WHICH EMPHASIZES AUSTERITY IN OPERATIONAL NAF SUBSIDIES TO ALLOW FOR EMPHASIS ON CAPITAL REQUIREMENTS.

INVESTMENTS

WITH ALL OF THE CONCERNS IN THE FINANCIAL WORLD OVER THE SAFETY OF INVESTMENTS, IT IS UNDERSTANDABLE THAT THIS COMMITTEE SHOULD BE CONCERNED ABOUT THE SAFETY OF THE FUNDS THAT THE NAVY INVESTS ON BEHALF OF MWR. I AM PLEASED TO REPORT THAT WE HAVE REMAINED VIGILANT IN THIS AREA; OUR PROGRAM CONTINUES TO COMBINE

THE BEST ELEMENTS OF FINANCIAL RETURN AND SAFETY OF PRINCIPAL.

NAVY NAF FUNDS ARE INVESTED IN GOVERNMENT BACKED/GUARANTEED SECURITY ARRANGEMENTS AND NAVY MWR HAS NEVER SUFFERED ANY LOSSES ON PRINCIPAL. INVESTMENTS INCLUDE FULLY COLLATERALIZED REPURCHASE AGREEMENTS, FEDERALLY INSURED AND FULLY COLLATERALIZED CERTIFICATES OF DEPOSIT, AND TREASURY AND AGENCY (E.G., FANNIE MAE) SECURITIES.

AS OF 28 FEBRUARY 1995, THE MWR MANAGED INVESTMENT PORTFOLIO AVERAGED AN INVESTMENT YIELD OF 6.76%. THIS COMPARES FAVORABLY TO THE AVERAGE MONEY-MARKET YIELD OF 5.36% FOR THE SAME PERIOD OF TIME.

THIS COMMITTEE HAS PREVIOUSLY EXPRESSED CONCERN ABOUT THE POTENTIAL BUILD-UP OF EXCESS CASH IN CENTRAL INVESTMENT PORTFOLIOS. OVER THE PAST FEW YEARS, THROUGH INCREASING OUR CONSTRUCTION PROGRAM AND OTHER COMMITMENTS, WE HAVE BROUGHT OUR CASH LEVELS DOWN TO THE POINT WHERE THEY REPRESENT CLEARLY LEGITIMATE RESERVE NEEDS FOR THE INVESTMENT PROGRAM, INCLUDING: CONSTRUCTION AND FACILITY IMPROVEMENTS (\$62.6M), WORKING CAPITAL (\$16.8M), ACCOUNTS PAYABLE (\$52.7M), CONTINGENCIES (\$4.4M), SELF-INSURANCE NEEDS (\$2M) AND EMPLOYEE BENEFITS (\$41.3M).

EFFICIENCY INITIATIVES

WHILE APF SUPPORT IS CRUCIAL, IT DOES NOT REPRESENT A UNILATERAL SOLUTION. WE RECOGNIZE WE MUST ALSO STRETCH OUR RESOURCES THROUGH INNOVATION AND THE USE OF SOUND BUSINESS PRACTICES. I'D LIKE TO DISCUSS SOME OF THE INITIATIVES WE'VE TAKEN IN THIS REGARD.

MANAGEMENT ASSISTANCE TEAMS

TO ENSURE THAT WE ARE GETTING THE MOST EFFECTIVE USE OF OUR APF AND NAF RESOURCES, WE HAVE ESTABLISHED MANAGEMENT ASSISTANCE TEAMS, A CONCEPT ORIGINALLY DESIGNED TO LIMIT FINANCIAL LOSSES AT CLOSING BASES. WE HAVE EXPANDED THE CONCEPT TO INCLUDE EXAMINING ALL OUR BASES TO ENSURE MAXIMUM OPERATIONAL EFFICIENCY. SINCE THE PROJECT'S INCEPTION, SEVENTEEN BASES HAVE RECEIVED A MANAGEMENT ASSISTANCE TEAM (MAT) ON-SITE REVIEW. COST SAVING RECOMMENDATIONS TOTAL \$4.6 MILLION. THE DIRECT COSTS TO SUPPORT THE INITIATIVE HAVE BEEN \$60,000 FOR TRAVEL.

MATS REVIEW ALL RECOMMENDATIONS WITH THE LOCAL COMMANDS AND OBTAIN THEIR CONCURRENCE, RESULTING IN STRONG SUPPORT FROM THE CHAIN OF COMMAND FOR IMPLEMENTING NEEDED CHANGE. FOLLOWING THE ON-SITE REVIEW, THE ASSISTANCE TEAM MAINTAINS CONTACT AND ARRANGES FOR ADDITIONAL SUPPORT AS NEEDED TO EXECUTE THE MORE COMPLEX CHANGES IN OPERATIONS.

MWR/NEX COMMON SUPPORT FUNCTIONS

WE ARE CONTINUING OUR COOPERATIVE EFFORTS WITH THE NAVY EXCHANGE ON CONSOLIDATING COMMON SUPPORT FUNCTIONS WHEREVER IT MAKES GOOD BUSINESS SENSE TO DO SO. THE RESULTS HAVE BEEN MIXED ON THIS INITIATIVE BUT WE HAVE MADE PROGRESS AND BELIEVE WE WILL CONTINUE TO DO SO AS SUCCESSES LEAD TO CLOSER COOPERATION.

COOPERATION HAS EXTENDED TO INCLUDE DEVELOPMENT OF A FOOD, BEVERAGE, AND ENTERTAINMENT MASTER PLANNING PROCESS WHERE WE LOOK AT ALL FOOD SERVICE OUTLETS ON THE BASE AND DETERMINE BASE FOOD AND BEVERAGE NEEDS. THIS EFFORT IS DESIGNED TO PREVENT NEEDLESS COMPETITION BETWEEN PROGRAMS AND ENSURE THAT WE ARE MEETING CUSTOMER NEEDS.

CORE PROGRAMS/STANDARDS

OUR MOST NOTEWORTHY SUCCESSES IN MAKING MWR MORE EFFICIENT HAVE BEEN THE IMPLEMENTATION OF FINANCIAL AND PERFORMANCE STANDARDS FOR REVENUE GENERATING ACTIVITIES. THE IMPLEMENTATION OF STANDARDS OF FINANCIAL PERFORMANCE WAS KEY TO THE TURNAROUND OF NAVY CLUBS. THE RESULTS HAVE BEEN THE SAME IN OUR OTHER REVENUE GENERATING ACTIVITIES, SUCH AS BOWLING AND GOLF. TYPES OF STANDARDS INCLUDE STAFFING, FACILITY SIZING, EQUIPMENT, ADMINISTRATIVE GUIDELINES, COST CONTROLS AND PROFIT STANDARDS.

WE ARE NOW CREATING STANDARDS AND THE NECESSARY MEASURING TOOLS FOR OUR MISSION ESSENTIAL AND COMMUNITY SUPPORT PROGRAMS. ALTHOUGH THESE STANDARDS ARE MORE COMPLEX THAN THOSE FOR REVENUE GENERATORS, WE HAVE MADE GOOD PROGRESS AND EXPECT TO BEGIN FIELD TESTING IN THE NEXT FEW MONTHS. THE RESULTS WILL BE QUALITY PROGRAMS CONSISTENTLY DELIVERED WITH MAXIMUM COST EFFECTIVENESS.

CONSTRUCTION OVERSIGHT/PROGRAMS

THIS COMMITTEE HAS ALSO PREVIOUSLY EXPRESSED CONCERN REGARDING THE LACK OF AN AGGRESSIVE RECAPITALIZATION EFFORT FOR MWR FACILITIES. THIS ISSUE HAS BEEN A PROBLEM FROM A CENTRAL PROGRAM SUPPORT STANDPOINT ALTHOUGH THERE HAS BEEN A GREAT DEAL OF LOCAL MAINTENANCE AND REPAIR WORK DONE OVER THE PAST SEVERAL YEARS. THERE SIMPLY HAS NOT BEEN ENOUGH APF SUPPORT EFFICIENTLY PUMPED INTO THE MWR SYSTEM TO ENABLE AN EFFECTIVE RECAPITALIZATION PROGRAM. INSUFFICIENT APPROPRIATED FUNDING HAS REQUIRED OUR RELIANCE ON VITAL NAF DOLLARS THAT SHOULD HAVE BEEN USED TO RECAPITALIZE OUR FACILITIES. WE ARE WORKING HARD TO RECTIFY THIS PROBLEM. WE WILL NEED TO MAINTAIN A STRONG FOCUS ON MWR WITHIN THE MILCON PROGRAM TO ENSURE THAT MWR PROJECTS STAY HIGH ON THE MILCON PRIORITY LIST.

BECAUSE OF OUR DECENTRALIZED STRUCTURE, WE HAVE A HEALTHY LOCAL NAF CONSTRUCTION PROGRAM WHICH HAS AVERAGED ABOUT \$28

MILLION PER YEAR OVER THE PAST DECADE, AND IS PROJECTED TO RISE TO \$32.2 MILLION IN FY95. WE CONTINUE TO SEE THAT LEVEL OF RENOVATION AND LOCAL PROJECT WORK DESPITE THE INCREASINGLY CONSTRAINED FISCAL CLIMATE. WE HAVE NOT BEEN AS AGGRESSIVE ON RECAPITALIZATION BECAUSE OF ADJUSTMENTS THAT WE HAVE HAD TO MAKE IN RESPONSE TO OUR NEW REVENUE ASSESSMENT AND PROFIT DISTRIBUTION SYSTEM. THERE HAS ALSO BEEN A RELUCTANCE TO INVEST TOO HEAVILY IN MAJOR PROJECTS UNTIL WE HAD A CLEARER PICTURE OF EXPECTED BASE CLOSURES. FY94 MWR NAF CENTRAL CONSTRUCTION INCLUDED 30 PROJECTS WORTH \$22.2 MILLION. WE ARE CURRENTLY REVIEWING THE FY-95 PLAN WHICH INCLUDES 3 PROJECTS WORTH \$10.2 MILLION. WE RECOGNIZE THE NEED TO EXPAND OUR CENTRAL CONSTRUCTION PROGRAM AND ARE CURRENTLY WORKING SEVERAL APPROACHES TO ENHANCE OUR BUILDING EFFORTS.

THE NAF PROJECT SUBMISSION PROCESS IS RIGOROUS, AND CONTROLLED CLOSELY THROUGH A THREE TIERED PROCESS TO ENSURE WE MAKE THE BEST USE OF FUNDS AVAILABLE FOR CONSTRUCTION. PROJECTS NOMINATED FOR FUNDING FIRST REFLECT THE LOCAL COMMAND PRIORITIES AS RECOMMENDED BY THE MWR DIRECTOR AND APPROVED BY THE COMMANDING OFFICER. THE HIGHEST PRIORITY PROJECT "NEEDS" ARE IDENTIFIED THROUGH A COMBINATION OF PATRON SURVEY RESULTS, FOCUS GROUPS, CONDITION OF EXISTING FACILITIES, AND AVAILABILITY OFF-BASE RECREATION AND CLUB OPPORTUNITIES. IF LOCAL NONAPPROPRIATED FUNDS ARE AVAILABLE, COMMANDING OFFICERS CAN AUTHORIZE NAF FUNDING UP TO \$200 THOUSAND FOR CONSTRUCTION REQUIREMENTS. FOR PROJECTS OVER \$200 THOUSAND AND UNDER \$500 THOUSAND, THE MAJOR

CLAIMANT, PROGRAM MANAGER AND MWR/NEX BOARD OF DIRECTORS (BOD) PROVIDE A STRINGENT REVIEW OF EACH PROPOSAL, WITH FINAL EXECUTION APPROVAL PROVIDED BY OSD. PROJECTS ABOVE \$500 THOUSAND ARE SUBMITTED FOR CONGRESSIONAL REVIEW PRIOR TO ACCOMPLISHMENT.

WE ARE DOING AN EFFECTIVE JOB AT THE LOCAL LEVEL IN RECAPITALIZING TO MAINTAIN OUR EXISTING STRUCTURES. WE HAVE THE FRAMEWORK IN PLACE TO EFFECTIVELY EVALUATE THE BEST PROJECTS FOR CENTRAL PROGRAM RECAPITALIZATION. WE NOW MUST PRIORITIZE AVAILABLE FUNDING TO SUPPORT AN EXPANDED PROGRAM.

PROGRAM HIGHLIGHTS

I THINK IT IS ALSO IMPORTANT TO APPRISE YOU OF THE MANY INTERESTING INITIATIVES WE HAVE UNDERWAY. THESE PROGRAMS RUN THE GAMUT FROM FAMILY SUPPORT PROGRAMS LIKE YOUTH AND CHILD CARE TO SINGLE SAILOR AND AFLOAT RECREATION AND FITNESS PROGRAMS.

THE MOST PROMINENT OF OUR FAMILY SUPPORT PROGRAMS IS CHILD DEVELOPMENT WHICH CONTINUES TO OFFER A VERY HIGH QUALITY PROGRAM AT AN AFFORDABLE COST TO PARENTS. IN AN EFFORT TO STRENGTHEN THAT QUALITY, WE HAVE EMBARKED ON A PROGRAM TO ENSURE THAT ALL OUR CENTERS COMPLETE THE NATIONAL ASSOCIATION FOR THE EDUCATION OF YOUNG CHILDREN (NAEYC) CERTIFICATION PROCESS BY THE END OF 1996. NAEYC CERTIFICATION IS RECOGNIZED AS A VALID INDICATOR OF QUALITY CHILD CARE. THIS IS AN AMBITIOUS UNDERTAKING WHICH ATTESTS TO OUR

ONGOING COMMITMENT TO A HIGH QUALITY CHILD CARE PROGRAM.

IN ADDITION, WE ARE SEEKING TO EXPAND THE SCHOOL AGE CARE PROGRAM IN CONJUNCTION WITH LOCAL SCHOOL SYSTEMS TO PROVIDE GOOD PROGRAMS BEFORE AND AFTER SCHOOL. WE HAVE ALSO CONTINUED TO DEVELOP NEW YOUTH PROGRAMS AND INNOVATIVE WAYS TO RESPOND TO THE CHANGING TASTES OF THIS GROUP.

FITNESS HAS BEEN A GROWTH AREA FOR THE NAVY IN THE PAST YEAR. THE CNO'S DIRECTION FOR ALL SAILORS TO EXERCISE AT LEAST THREE TIMES A WEEK HAS RESULTED IN THE ELIMINATION OF FITNESS FEES FOR ACTIVE DUTY AND ACTIVE RESERVE MEMBERS. IT HAS ALSO GENERATED INTEREST IN MANY SPECIAL EVENT FITNESS PROGRAMS LIKE WELLNESS FESTIVALS, FITNESS TESTING, FITNESS CONTESTS AND EVEN SOCIAL EVENTS BUILT AROUND THE FITNESS THEME. THIS MOST HEAVILY UTILIZED OF MWR PROGRAMS ASHORE SHOULD CONTINUE TO GROW IN THE OUTYEARS.

EXAMPLES OF FITNESS PROGRAMS FOR SHIPBOARD SAILORS INCLUDE UNDERWAY AEROBICS, BASKETBALL TOURNAMENTS, AND ATHLETIC EVENTS PLAYED AGAINST HOST NATION TEAMS IN FOREIGN PORTS.

FOR THE SINGLE SAILOR LIVING IN BACHELOR QUARTERS, WE ARE BUILDING PROGRAMS DESIGNED TO PROVIDE HEALTHY RECREATION ALTERNATIVES THAT GET THEM OUT OF THE BARRACKS. WE SPONSOR HEAVILY ADVERTISED SPECIAL EVENTS LIKE BLOCK PARTIES, TRIPS TO

LOCAL ATTRACTIONS, HIGH ADVENTURE TRIPS, AND FAST FOOD TRAVELING PARTIES. WE PLACE PARTICULAR EMPHASIS ON OUTDOOR RECREATION PROGRAMS (E.G., RAFTING, ROCK CLIMBING, AND CAMPING).

IN FOOD SERVICE, WE ARE FOCUSING ON QUICK SERVICE TYPES OF PROGRAMS DESIGNED TO PROVIDE THE KINDS OF FOOD AND ATMOSPHERE THAT OUR PATRONS TELL US THEY WANT. WE CONTINUE TO FOCUS ON DE-EMPHASIZING ALCOHOL AND ENCOURAGING FOOD, ENTERTAINMENT AND PARTICIPATION IN OUR CLUB PROGRAM. IN THIS PROGRAM WE MEASURE SUCCESS BY THE BOTTOM LINE AS OUR PATRONS INDICATE THEIR LEVEL OF SATISFACTION BY HOW THEY SPEND THEIR DOLLARS.

MWR HAS MADE EFFECTIVE USE OF COMMERCIAL SPONSORSHIP INITIATIVES WHICH HAVE PROVIDED NEEDED SUPPORT FOR MANY MWR SPECIAL EVENTS AND INCREASED COOPERATIVE INVOLVEMENT WITH PUBLIC AND COMMERCIAL SECTORS.

EMPLOYEE BENEFITS

WE HAVE BEEN COOPERATING CLOSELY WITH DOD ON THEIR PLANS TO FULFILL THE TASKING RECEIVED FROM THIS COMMITTEE LAST YEAR TO REVIEW HEALTH BENEFITS PLANS AND CREATE A COMMON HEALTH BENEFIT PROGRAM FOR ALL DOD ACTIVITIES. THIS ISSUE IS VERY COMPLEX DUE TO THE DIFFERENT PLANS DEVELOPED BASED ON SERVICE SPECIFIC NEEDS.

SUMMARY

WE ARE MOVING OUT AGGRESSIVELY ON MANY FRONTS TO ENHANCE OUR MWR SYSTEM. WE REQUEST THE SUPPORT OF THIS COMMITTEE FOR FORTHCOMING APF FUNDING REQUESTS. FOR OUR PART, WE WILL CONTINUE TO TAKE THE LEAD ON STREAMLINING THE WAY WE OPERATE, BUILDING ON MWR PROGRAM STRENGTHS AND IMPROVING AREAS OF WEAKNESS.

Mr. MCHUGH. Thank you, Admiral.
We next recognize Col. Stevan Richards. Colonel.

**STATEMENT OF COL. STEVAN B. RICHARDS, DIRECTOR,
DIRECTORATE OF SERVICES, U.S. AIR FORCE**

Colonel RICHARDS. Thank you, Mr. Chairman, and members of the MWR Panel for giving me the opportunity to present testimony before you today. Secretary Woodenall, General Fogelman, and General Morman, the chairmen of our MWR Board, see quality of life as a key contributor to Air Force readiness. As a result, they have established our "People First" initiatives to prioritize and meet our people's needs in terms of quality of life.

"People First" looks at a full spectrum of what quality of life means for Air Force people, but its primary objective is to develop the right environment to recruit and keep the best quality force possible for the Air Force. Of course, MWR directly contributes to those objectives by creating the right environment for individual family, unit, and community well-being.

As part of the "People First" team, we are proud of the accomplishments of past years in supporting Air Force people. For example, we currently have over 300 MWR people deployed in the field in support of 10 humanitarian and peacekeeping operations while, at the same time, providing world-class support to the families and their coworkers left behind at home stations.

We have increased funding of our category A and B activities to more closely reflect congressional intent. We have placed major emphasis on nonappropriated fund construction. Starting in 1994, we have funded over 153 projects valued in excess of \$260 million, and we continue to maintain strict oversight over our construction processes and priorities, as well as our investment policies.

Last year we saved the Air Force and other services over \$44 million of nonappropriated fund purchases through cooperative efforts with our Air Force nonappropriated fund central purchasing office. We have accredited 93 percent of our child development centers while holding costs down. As a matter of fact, today 75 percent of Air Force people that use our child development programs pay less than they did in 1989.

As you know, there are always more efficient, creative ways to do things. Therefore, we are aggressively pursuing initiatives that will add value to our programs. As an example, starting with a blank sheet of paper, we are doing bottom-up reviews of clubs, fitness centers, community centers, and skill development activities. We are developing standards for all of our activities based on the customer's view of quality and industry's measures of efficiency.

We are using technology to cut costs and deliver higher quality of service to our customers faster. We are also pursuing outsourcing opportunities where it makes sense for the mission and the customer. We have already successfully outsourced our club member accounting system, and we are currently working on a partnership to enhance our youth programs.

While we are proud of our recent successes and excited about our initiatives just mentioned, many challenges certainly lie ahead. For example, finding ways to meet growing customer demands. An example is that the demand for child development and fitness far ex-

ceed our current capability. The Air Force's "People First" initiatives have identified manpower and facilities requirements as high priorities in these areas.

We need to continue to exploit technology and accepted industry practices to lower cost and speed delivery. And we are exploring additional partnerships with our sister services, or continue to explore outsourcing opportunities. Basically, our goal is to drive up quality and drive out unnecessary cost, and to deliver value to our customers; that is, to Air Force people and their families.

The Air Force leadership is fully committed to maintaining the quality of life of Air Force people. And, at all levels, commanders fully understand the importance of these programs and the need to exercise prudence and responsible stewardship of taxpayers' and troops' dollars. The Air Force is grateful for the Panel's continued support and guidance, and we thank you for this opportunity to come here before you today.

**Statement of
Colonel Stevan B. Richards
Air Force Director of Services**

**Before the
House National Security Committee
Morale, Welfare, and Recreation Panel**

29 March 1995

**For Official Use Only Until Released by
the House National Security Committee**

Thank you Mr. Chairman, and members of the MWR Panel for giving us this opportunity to bring you up to date on the Air Force's MWR program. This written testimony will give you an update on initiatives mentioned last year, as well as address new initiatives started since then.

It has been a very fast paced and challenging twelve months since our last opportunity to address the Panel. World events have continued to involve the Air Force in contingencies around the globe, and the Air Force Services organization (responsible for MWR programs as well as troop feeding, lodging, and mortuary affairs) has been on hand to support the quality of life of our troops in the field as well as their families and coworkers back home. The Secretary and the Chief of Staff of the Air Force see quality of life to be of central importance to readiness. They have established the "People First" Quality of Life Priorities to focus attention on fulfilling the needs of the Air Force's most important asset--our people.

The "People First" Quality of Life Priorities looks at the full spectrum of how the Air Force supports its people. It covers compensation, housing, health care, family and community support, retirement benefits, and education benefits. The primary objective of this initiative is to develop the right environment to recruit and keep the best quality force possible. MWR is an integral part of this initiative, and is a major and direct contributor to creating the right environment for individual, family, unit and community well being.

Under "People First," we want to alleviate some of the stress incurred as a result of increased operational tempo (OPTEMPO). The Air Force assigns Services troops to remote locations and deploys them on contingency operations to provide basic support like food service and lodging, and MWR programs to keep them fit and to help relieve the stress from military operations and long separation from families. We currently have over 300 Services troops in the field supporting 10 contingency operations. At the same time, we provide the families and coworkers (who often have increased responsibilities) remaining at home bases with MWR programs that help them cope with the added stresses placed upon them.

“People First” also looks to enhance base programs to create an environment that nurtures a sense of pride and commitment to the mission. These enhancement initiatives include expanding our fitness and child development programs--both are programs where the demand exceeds our ability to respond. The initiative also looks to enhance dining facilities for our single airmen, and libraries in support of education programs.

Finally, “People First” includes initiatives to improve the quality of life and readiness of our people through support of preventive health care. We are improving fitness programs and assisting the Air Force medical community in implementing “Wellness Centers” that provide health and fitness assessments, counseling, referral, and education services in a “one-stop-shop.”

Through “People First”, the Air Force has focused the efforts of several disciplines to enhance the overall quality of life of Air Force people to ensure that we continue to recruit and retain a ready force. In addition to these initiatives, Air Force MWR programs are continuing to pursue the improvements mentioned in last year’s testimony, and are undertaking additional initiatives designed to improve our ability to deliver value to our customers. Last year, we described our corporate policies, our strategic plan, and our efforts to improve the efficiency and quality of our programs. We are already seeing dividends from these initiatives.

Through our basic operating philosophy of “central policy and decentralized execution,” Air Force senior leadership established clear direction and expectations which subordinate commanders have implemented to meet congressional mandates and DoD policy. Broad policies to organize, train, equip and fund MWR programs according to Congressional intent and customer needs have aligned resource allocation and execution with program requirements. For example, fitness centers, libraries, and community centers (category A activities) should be supported almost entirely with appropriated funds (APFs), with little to no nonappropriated funds (NAFs). For FY 94, the Air Force APF support covered 93 percent of authorized costs in these activities, an increase from 84 percent the previous year. This freed up troop dollars (NAFs) for more

appropriate use in category B activities (outdoor recreation, child development and youth activities, skills development, etc) and category C activities (bowling, golf, clubs, etc) to increase services and lower prices to customers.

Likewise, revised cash management and construction policies have improved the use of available NAFs to enhance the overall quality of AF MWR programs. We informed you last year that we pooled available NAF cash from major commands and bases in April 1992 to establish the Air Force Base Capital Improvement Fund (AFBCIF). Since then, we have reduced the level of NAF cash in the field, accelerated needed capital improvements, and funded requirements based on the Air Force-wide priority of need. Currently, the level of cash in the field is sufficient to cover this year's locally funded equipment and minor facility projects. Capital spending at all levels is 37 percent higher than it was before this initiative. Since 1994, the first year under the centralized NAF construction program, we have approved funding for 153 projects totaling in excess of \$260M. Customers can now see their dollars being put to work improving facilities to support their quality of life.

The Air Force maintains a stringent oversight and prioritization system for NAF construction to ensure the most needed facilities are constructed first. Projects are not considered for funding unless supported by a valid assessment of need. Projects costing \$500 thousand and above require an assessment accomplished by an independent contractor. And, as mentioned last year, the AF is conducting comprehensive assessments of base-wide MWR requirements at all installations to establish a master plan for programs and facilities in the context of future needs.

The Air Force continues to apply equally stringent oversight to NAF investments. Air Force policy is to only invest in instruments that meet the highest standards for safety, yet still provide for liquidity and competitive yield. This means the AF invests NAF operating funds only in fixed-income securities: certificates of deposit issued by Federal savings banks insured by the Federal Deposit Insurance Corporation that meet specified safety criteria; bonds and notes issued by the Treasury Department; and basic direct

obligations of other US Government agencies. In addition to those investment vehicles, the NAF employee retirement portfolio also includes index funds, which are designed to match the performance of major market indices (like the Standard and Poor's 500 Stock Index). These investment strategies are audited annually, and the investments and audits are reviewed periodically by an independent committee of senior financial managers from the Air Force and the US Department of the Treasury to ensure they meet the standards of safety, liquidity and competitive yield. Prudent management of taxpayer and troop dollars is a core principle of Air Force Services, and part of our motivation in exploring better ways of serving our customers.

Last year we told you about our initial efforts at benchmarking with industry to determine our direction in clubs. We have expanded both our benchmarking efforts and our exploration of new club concepts. We expanded on what we learned from the Private Sector Council to pursue a bottom-up review of the Air Force club program. As a result of their recommendations, we revised our vision of clubs and validated our direction with club members and commanders through a series of focus groups conducted by an independent contractor. With the aid of this guidance, we are now developing new concepts we expect to implement in a prototype program within the next year.

We have expanded our benchmarking efforts to improve a number of diverse areas, to include accounts payable and unemployment compensation administration, lodging operations, fitness programs, and management of golf pro shops. We have tied process improvements gained through our golf pro shop efforts into our central purchasing program to deploy improved merchandising and inventory control practices Air Force-wide. Our goal is to capitalize on proven efficiencies within government and industry.

We are continuing to reap benefits from our use of central purchasing through the AF NAF Purchasing Office (AFNAFPO). Our purchasing team has continued to improve on our capability to meet base needs through nationally negotiated contracts. Estimated savings on purchases of \$190M in FY 94 were \$44M (23 percent) for a total of \$222M in

savings over the past five years. They not only provide this benefit to Air Force bases, but also provide purchasing services to Army, Navy and Marine Corps installations. AFNAFPO is currently developing "on-line" automated purchasing services to eliminate paperwork requirements and cut the time between orders and delivery, which will eventually cut inventory requirements and save manpower and dollars.

As we mentioned last year, we planned to upgrade the information systems at all our bases to give base-level management teams access to up-to-date tools, such as the on-line automated purchasing system. We have completed installation of the first stage of local area networks at all our main operating bases, and are providing them with a package of management systems (and the training to use them) that will help them manage customer services, payroll costs and inventory requirements. Eventually we see these systems becoming the backbone of our management processes, leading base level managers to standardized processes and measurements of performance, which will result in more consistent customer service Air Force-wide.

Also as mentioned last year, we implemented planning standards to focus base level efforts on achieving important milestones and develop measurement processes. As a result of their experiences, we are now developing follow-on standards that prescribe measurement of key customer indicators for quality, and industry standards of efficiency and effectiveness. Wherever possible, we have looked to industry to develop these standards and measurement processes--again benchmarking on the best we can find. Our goal is to drive up quality and drive out unnecessary costs.

One area where we see exceptional results from our efforts in attaining externally mandated standards is child development. We are extremely proud that 93 percent of Air Force child development centers accredited with the National Academy of Early Childhood Programs (nationally only 4 percent of centers are accredited). In addition, 100 percent of our centers meet DoD/Air Force certification requirements (the Air Force equivalent to state licensing). Certification verifies that centers meet health and safety

standards. Accreditation verifies that our centers meet high standards for early childhood development programs, curriculum and staff interaction.

The Air Force child development program has been able to meet these strict quality standards while achieving the lowest cost per child in DoD (this includes APF support, parent fees and NAF subsidy). Fees (in constant dollars) for 75 percent of parents are lower today than in 1989 prior to the enactment of the Military Child Care Act. NAF subsidy for the first quarter of FY 95 was only \$50 thousand--less than a half of a percent of fees in excess of \$11M. This also represents an 85 percent reduction below the level of the FY 94 first quarter subsidy. Vision and focus have enabled us to achieve quality in our child development programs. We are emphasizing use of the same process in other activities.

We have done a bottom-up review of fitness activities, revising the mission, vision and program to better meet Air Force's requirement for a fit force, and at the same time, match the program desires of our customers. We are using our new program concepts to drive facility, equipment and manpower requirements. We have started the same process for community activity and skill development programs. As part of our strategic review, we will eventually look at all of our programs, aligning them closer to customer needs, and improving quality through adherence to Total Quality Management (TQM) practices.

We have updated our strategic plan to focus on delivering value to our customers. Our strategy is to use TQM practices to improve quality while driving out costs that do not add value to the service. TQM has become an integral part of the Air Force way of doing business--these concepts are recognized as "Quality Air Force". Air Force Services is capitalizing on this new culture to effect change in the way we do business. Air Force inspections evaluate base level programs based on the Malcolm Baldrige Quality Award criteria. We have modified our awards programs to review similar criteria to choose our best programs. We have also improved on our market surveys to better understand our customers. In addition to our market analysis survey (Corporate Prism) which measures

market share and desired improvements, we have also instituted a customer satisfaction survey to measure customer response to these improvements.

As we have already mentioned, we are using benchmarking, effective purchasing, and standards to drive up quality and drive out unnecessary costs. In addition, we are contracting services and developing partnership relationships with industry where doing so makes sense for the mission and the customer. Currently, we are working with industry to provide a more efficient and effective club card, to enhance employee benefits through a 401 (k) program, and to develop quality programs for our youth.

The Air Force has recently established a contract with a major financial institution to replace our antiquated in-house club member accounts receivable system. We had previously managed separate accounts receivable systems at each installation, tying up resources and manpower in an area that is not a core function of MWR. By using a combination of a commercial credit card and proprietary charge card, we are able to offer our members additional credit and other services at a considerable savings to the Air Force, while at the same time, increase our ability to prevent credit misuse and abuse. We estimate we will save approximately \$4.3M annually compared to the cost of our in-house system. Over five years of successful experience in AF Material Command (AFMC) shows we will be able to achieve these savings and increase membership benefits without the highly-publicized problems associated with the government travel card. The Air Force program does not promote "credit for everyone". Rather, it offers club cards for those who wish to join, and expanded, tightly controlled, commercial credit opportunities for those who have demonstrated their ability to use it wisely. Our experience in AFMC has been positive, where costs came down, membership increased, credit problems were virtually nonexistent, and delinquent-account rates were even lower than those experienced by our in-house charge systems.

In addition to out-sourcing existing requirements, we have looked to industry for assistance on new initiatives. As we established a new 401 (k) savings plan for our NAF employees, we elected to contract out the administration and record keeping from the

start. Similarly, as we determined there was a need for upgrading youth programs, we chose to seek industry assistance, rather than develop programs, training, marketing campaigns, etc., in-house. We are working with the Boys and Girls Club of America, to benefit from their solid infrastructure that already produces off-the-shelf programs, training, and marketing campaigns featuring nationally recognizable celebrities.

Today, the Air Force MWR program capitalizes on our past experiences and successes, and uses quality methods, technology and industry assistance to develop a strong quality of life program for the future. Air Force restructuring, base closures, and budget downsizing have created a watershed of change that has been both beneficial and detrimental. One area where we need assistance is in obtaining access to Base Relocation and Closure (BRAC) proceeds from the sale of real property in which there is a NAF investment. Current law requires that proceeds from such sales (representing the depreciated value of the NAF investment) be deposited in a treasury account, where they can be assessed by the Secretary of Defense only through the appropriations process. This is a cumbersome arrangement. The Air Force has proposed legislation to DoD to have these proceeds transferred directly to a NAF instrumentality under the control of the Secretary of Defense to expedite their use for authorized NAF purchases.

The Air Force leadership is fully committed to maintaining the quality of life for Air Force people. They have structured policies to ensure congressional mandates for MWR programs are fulfilled, and Air Force commanders at all levels understand the importance of these programs and the need to exercise prudent and responsible stewardship of taxpayer and troop dollars. The Air Force works mission requirements as a team, and MWR programs are no exception. This cooperation in developing MWR programs as key elements of quality of life ensures Air Force people receive programs to meet their needs.

We are grateful to the MWR Panel for the continued support and guidance that has sustained MWR programs as a valued entitlement and important component of readiness. Air Force people are working long hours either in deployed locations or back at home

bases filling their deployed coworkers' jobs. Continued high OPTEMPO and long separations from family members make MWR programs essential to sustaining the readiness of our heavily tasked forces. We will continue to provide quality programs and services to sustain them as a fit and ready team to defend America. Thank you for this opportunity to update the Panel on our continuing initiatives, current concerns and future plans to support the quality of life of Air Force people.

Mr. MCHUGH. Thank you, Colonel. Last, but certainly not least, is Brig. Gen. James R. Joy, USMC, retired.

STATEMENT OF BRIG. GEN. JAMES R. JOY, U.S. MARINE CORPS (RETIRED), DIRECTOR, MWR SUPPORT ACTIVITY, HEAD-QUARTERS, U.S. MARINE CORPS

General JOY. Mr. Chairman, and distinguished members of the Panel, it gives me a great deal of pleasure to represent the U.S. Marine Corps here this afternoon and to tell you a little bit about our program.

I am not going to go into a great deal of detail as far as the delivery of the program because I think it pretty much is a mirror image of what you have heard. I would like to point out though that our basic organization is somewhat different than the DOD model. What I am alluding to is, in 1988 the Marine Corps decided to merge, at the local level, the Marine Corps exchange and the MWR system. The idea, to reduce overhead at the installation level with a single unified personnel system, a single accounting system, a single management information system, et cetera.

I am not here to tout that that program is for any of the other military services. However, we feel it served the Marine Corps very well. That is the good news. The bad news is, I will be back to talk to you next week about the exchange because I, of course, represent the exchange.

Sir, I would like to move now to continuing to talk a little bit about the challenges that we faced over the past few years. I am sure you realize that the Marine Corps, as far as the drawdown, has probably not been hit as severely as the other services. We have had a drawdown from 194,000 down to 174,000, and we have achieved that level. So the worst of that is behind us. However, it has not been painless. The loss of personnel has resulted in a reduction of sales which has affected our profits and dividends.

Like everyone over the past few years, we have faced severe increased competition from outside the gate; competition for exchanges, clubs. And for the Marine Corps in particular, we have had a severe shortage of appropriated funds over the past few years. You should understand that this shortage of appropriated funds has not been as a result of the commitment of the commandant of the Marine Corps to the MWR Program. In fact, the commandant, as a percent of the total obligation authority that he had, put as much as a percentage into MWR as any other service chief.

The problem in the Marine Corps is the fact that we are a very people-intensive organization and the commandant's discretionary spending, the money available for Milcon, for procurement, and operation and maintenance, the dollars have just not been there. Later on I will explain that that problem has been recognized and we think we are well on the way in POM 1996 to alleviate that problem.

Even though we have had difficult times in the last few years, our programs have continued to grow and prosper and, at the same time, we have kept fees and charges in our program under control. Like everybody, there has been a slight increase in fees and charges but we have not priced ourselves out of the business.

In response to the challenges of the past and the challenges ahead, like all the services we have developed a strategic plan. There are six key points in that strategic plan, and I will just highlight them. I will be glad to address them further in the question and answer period.

First, we are serious about restructuring MWR. Although we think we already have a lean organization, we feel that the support organization still can be pared down. Just last week we had a week long conference at the Xerox Training Center at Leesburg, VA, where we addressed that. We are going to be taking reductions in the support of our organization; those aspects of the organization that are invisible to our customers.

We also have as a goal in our strategic plan to ensure that our programs are customer focused. That we are providing programs that the customer wants, not necessarily what our MWR director or commander wants. We also are developing what we call "core programs"; programs that will be consistent throughout the Marine Corps. We want to have that when a marine, and his family, goes from base to base throughout the Marine Corps, he finds the same program at each installation.

Of course, one of our goals is to fully resource the program. We are not there yet, but we think that if the budget we have got is supported, we are well on the way to fully resourcing our program. Like all the services, we have to continually aggressively invest in our infrastructure. We have a very strong capitalization program, but this year we had \$25 million in our central capitalization program. As a result of the cash sweep that was directed by this Panel last year, we have added an additional \$20 million in capitalization that is going to be completed in fiscal year 1995.

Again, like all the services, we have problems at our management information system. One of our goals is to upgrade and refine our management information system. We are well on the way to start that. As we speak we are testing the introduction of a new electronic point of sale system. Also, we have recently entered into an agreement with the Navy exchange command to provide our retail merchandise and accounting system.

Our last goal has to do with people. We have a goal to renew our attention to the recruitment, the retention, and the development of our work force. Like all the services, our people are our most important commodity and we feel we need to renew our efforts in that regard.

Sir, the last couple of years have been a watershed period, as far as appropriated funds for the Marine Corps. I alluded to the problems we have had in the past. The Secretary of Defense recognized the problem the commandant had and in fiscal year 1995 provided us a \$10 million plus-up for MWR. That was an important shot in the arm to our programs.

We have also been successful in the POM 1996 process to have the Marine Corps and the Secretary of the Navy approve a POM initiative of \$20 million each year throughout the POM. Additionally, the Secretary of Defense plus-up that Mr. Pang referred to, the Marine Corps again will be a major benefactor of that, an additional \$20 to \$22 million per year over the life of the POM. So, as

I said before, we are not fully resourced, but we think we have made substantial improvements over the last 2 years.

Two other points I would like to make, to build on comments that several of my colleagues have made, in regard to cooperative ventures. The Marine Corps being the smallest of the services, we feel that we can benefit greatly from cooperative initiatives with the other services. I just want to highlight several of them. They are not in any priority, but just to give you a feel for the cooperation that is going on among the services.

First off, cooperative buying. In our exchange system we do a substantial dollar value of cooperative buying with the Navy exchange and the Army and Air Force exchange. In regard to our club projects, we are involved in the Army's prime vendor contract where we buy club projects.

Speaking of the Army, we have a couple very successful memoranda of understanding with the Army. The first has to do with club design. The Army is assisting us in designing clubs. We are presently building a tri-modular club at Quantico, VA, that will be completed next month. In fact, as I understand it, we are building the Army's club of the future before the Army was able to build it. The Army designed this club to be built at a base in Germany that ended up being closed. We had a requirement at Quantico for three new clubs; a \$15 million capital investment. We are building a trimodular club, three clubs in one facility for half the price.

Another successful initiative with the Army has to do with our gaming machine operation in the Far East. Last year we were faced with a capital investment of about \$4 million to be shared between our bases in the Far East and our headquarters. We signed an MOU with the Army. The Army took over our program. Not only did we save that capital investment, but they have doubled the revenues that we are receiving from the program as a result of the introduction of new machines.

This next cooperative effort happens to be with the exchange system, but we have our credit program for the exchange. Instead of us starting our own credit program, we have a memorandum of understanding with AAFES for their deferred payment plan. Again, to save us the significant investment in infrastructure to set up a credit program, and also to keep from having the large accounts receivable that we would have, we have outsourced that. I already mentioned our outsourcing of our retail merchandise accounting system with NEXCOM.

Sir, the last thing I would like to mention is a quality of life study that you may or may not have heard of. Three years ago my office chartered a quality of life study. The idea was to take a look for the first time at the effect of quality of life on such things as retention, personal, and unit readiness within the service. As I said, it was a 3-year study, with 10,000 marines interviewed; a very good sampling of the Marine Corps. It was conducted by the Naval Personnel Research Development Center in San Diego.

But the study could not have been completed at a more opportune time. It was just completed at the time that we were the beneficiaries of this plus-up. What it is enabling us to do now is to properly resource those things that our marines are concerned about in regard to the quality of life.

The last point I will make in closing is, this quality of life study covers much more than just MWR. It also deals with barracks, family housing, the commissaries, et cetera.

Sir, with that I will close, and I will be happy to answer any questions.

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NATIONAL SECURITY COMMITTEE

STATEMENT OF
JAMES R. JOY
DIRECTOR
MORALE, WELFARE AND
RECREATION SUPPORT ACTIVITY
U.S. MARINE CORPS
BEFORE THE
MORALE, WELFARE AND RECREATION PANEL
OF THE
HOUSE NATIONAL SECURITY COMMITTEE
29 MARCH 1995

NOT FOR PUBLICATION UNTIL
RELEASED BY THE HOUSE
NATIONAL SECURITY COMMITTEE

Mr. Chairman and distinguished members of the Morale, Welfare and Recreation Panel. It is a distinct pleasure to appear before you today and have the opportunity to bring you up to date on our Marine Corps Morale, Welfare and Recreation Program.

Before turning to specific aspects of our operations, I would like to preface my remarks with a brief overview of how our organization is structured, which is somewhat different from those of our sister services.

In July, 1988, the Marine Corps acted to be more business like by merging MWR programs into a single nonappropriated fund (NAF) instrumentality, with consolidated management, operations, and support elements. This consolidation created a unique quality of life delivery system within DoD, as the other services' exchange and MWR programs remain separate entities. Though not the DoD model, it made excellent business sense for us to join under a single management umbrella the programs and activities which shared the common goal of supporting the quality of life of Marines and their families. We were able to realize economies of scale and reduce a number of organizational redundancies.

Marine Corps MWR now possesses a unified work force and a single overhead support system. We believe that this unified structure enables us to more directly and efficiently meet the morale, welfare, and recreational needs of our Marines and their family members. Responsibility for these programs remains in the hands of those directly responsible for taking care of the service member, the installation commanders.

Marine Corps MWR provides exchange, food and hospitality, and recreational programs and services to approximately 174,000 active duty military personnel, 203,000 military family members, and an estimated 314,000 retirees. The MWR program employs over 12,000 people, and generates sales income of almost 700 million dollars annually. Our charge is the development and delivery of quality, cost effective programs wherever a Marine is stationed.

The majority of our sales is from our exchange system but they are augmented by income from bowling centers, clubs, and other revenue generating programs. This past year our net profit was \$17M which provided a dividend of \$111 per Marine. Profits are down 13% and dividends are down 20% from FY 93 due to smaller margins on sales and increased facility maintenance and repairs.

Looking forward through the remainder of the decade, we see significant challenges, as well as a number of key issues which require our attention if we are to continue to offer our Marines the quality, variety, value, and service they have every right to expect of us. We are not exempt from the sweeping changes affecting American business, society, and its military services. Our bottom line must always be the continuous improvement of the goods and services we deliver every day.

The past several years have seen substantial growth in our MWR programs despite a challenging operating environment, characterized by force structure reductions, increased competition for the leisure time and dollars of Marines, rising employee health care costs, and less appropriated fund support. The programs we offer have continued to expand, though the money

to fund them from our MWR revenue generating activities becomes more difficult to generate each year. Our recreation programs have improved to meet customer demand, yet user fees remain modest. That is the good news.

The disturbing news is that recreation programs and capitalization requirements have each year been costing us more. This underscores the necessity for MWR to streamline and restructure operations in order to remain profitable, competitive, and responsive. For the near term, we must actively develop initiatives that enable us to divest ourselves of unprofitable and inefficient practices and aggressively pursue the recapitalization of the MWR program.

The Marine Corps response to these external challenges is found in our Marine Corps MWR Strategic Plan, which charts a course for the future based on seven key goals. These are: to restructure MWR to gain economies and efficiencies that allow for optimum resourcing and delivery of MWR programs; to have viable, customer-focused core and locally tailored programs consistently applied across the Corps; to aggressively invest in equipment, facilities, and infrastructure that enhances our programs and meets the needs of our Marines; to fully resource the Marine Corps MWR program; to improve and refine our information systems that enable us to capitalize on the best practices of industry leaders; to recruit, train, develop, and empower a quality work force; and to be recognized as a consistently superior and responsive organization, promoting quality of life in partnership with our customers.

Restructuring our MWR is a top priority. To this end, we are presently undergoing a review of our structure to identify those functions that are candidates for centralization, regionalization, decentralization, outsourcing, or elimination to create a lean, viable, responsive and effective organization. We are committed to creating the most efficient and effective support structure possible for the MWR program.

At the same time, we must assure our Marines that MWR programs and services meet high operating standards. We must be able to assure Marines that the programs and activities available at our commands are equal to those available in the civilian community.

Our strategic plan calls for us to aggressively recapitalize Marine Corps MWR by fully resourcing our program and by investing in the equipment and facilities that are sorely needed by our Marines. Constrained appropriated fund support over the years presented us with a very difficult operating environment. However, recent quality of life funding initiatives (DoD and USMC) have resulted in substantial increases in support for MWR programs and bring the Marine Corps MWR into parity with the other services. We will make significant improvements in our programs such as fitness centers, recreation centers, libraries, and improving the MWR physical plant.

Our MWR facilities have long been a concern, and we are working diligently to ensure they meet the needs of our Marines and are in excellent condition. Because of past years' constrained funding, many of our facilities are in dire need of

refurbishment, upgrade, and repair. Our research tells us that these facility deficiencies are obvious to Marines, and impact our program delivery. To meet this challenge, we have established an inventory and database of all MWR facilities, are developing a facilities life cycle management model to address our long term requirements, and are developing a more responsive process to identify and approve construction and renovation projects. To meet our short term needs, we moved to strengthen our FY95 NAF Construction Program from \$24.9M to \$50.2M. This increase is made possible because of more aggressive use of our cash assets.

Marines and their families deserve the best MWR facilities we can provide. I believe our facility improvement efforts will provide a big pay back for our commands and greatly enhance the quality of life of our Marines.

To move ahead and survive in the information age, MWR must improve and refine our information systems. To this end, we have joined with the Navy Exchange System Command (NEXCOM) in a cooperative initiative to pursue a joint retail and accounting management information solution. We are currently testing a new electronic point-of-sale system in our exchange at MCAS Cherry Point. When testing is complete, the system will be installed at our remaining exchanges. We are also seeking an electronic point-of-sale solution for our food and hospitality and recreation activities that will increase our efficiency and enable us to better serve our customers.

As I have stated, Marine Corps MWR represents a rather

unique quality of life delivery system within DoD. Our exchanges produce significant NAF revenue which provides support for the remainder of our MWR program. This is a complementary relationship. Our exchanges are a vital part of our total QOL delivery system. We are fully committed to cooperative efforts among the services. These cooperative business partnerships lower our costs, provide greatly increased choices and services for our customers, and also provides them with increased savings. For example, in 1992, our exchanges ordered \$1.5M in merchandise from Army and Air Force Exchange System (AAFES) and NEXCOM. By 1994 the total had jumped to \$15M, and we project orders totaling \$60M for 1995. We signed a memorandum with Navy MWR to manage their Workmen's Compensation program. NEXCOM employees are participating in our MWR 401(k) Program. Our partnership with AAFES in design and construction of facilities is working well. In FY95 AAFES will design and construct approximately 29 of our projects valued at an estimated \$26.9M. Our participation in the AAFES Deferred Payment Plan has enabled young Marines and Marine families to obtain much needed credit as they establish themselves and their families in our society. These cooperative agreements assist us in providing high quality MWR services.

One recent accomplishment of which we are most pleased is our sponsorship of the Marine Corps Quality of Life Research Project; a three year undertaking which surveyed over 10,000 Marines and spouses in CONUS and overseas. The research and the model developed from the data represent the first time that

quantitative data has linked quality of life programs to readiness and mission accomplishment. Aside from linking QOL programs to measurable military outcomes, the data provides the Marine Corps with significant in-depth information about our customers, their perceptions about life quality, and their needs. This data will give us an excellent ability to meet and exceed our customer expectations over the long term. The model developed from the data also gives us an excellent tool for determining the effectiveness of recreation and other quality of life programs on military outcomes, including personal readiness, retention and job performance.

In conclusion, Mr. Chairman, I appreciate the opportunity to give the panel this brief overview of the Marine Corps MWR system. Our watchword is to provide outstanding service to our customers each and every day. Customers are our first priority as we work to maximize our efficiency and effectiveness. I believe we will be able to continuously improve our customer service, maintain adequate profit margins, and be well positioned to manage the challenges which lie ahead. I invite you to visit our installations, talk to our Marines and their families, and to our commanders about our programs. I believe that you will share my strong belief that the quality of our programs is quite on target.

Again, thank you for this opportunity to tell the Marine Corps MWR story. I would be pleased to answer any questions you have.

Mr. MCHUGH. Thank you, General, and thank you all for your comments. Let me start with a broad-based question. General Joy spoke about the marines' efforts to provide corpswide programs that are consistent. It seems to me that is a pretty admirable goal. As I look back over the history of this Panel, there seems to be a consistent concern about the distribution of MWR initiatives in an equitable manner amongst the branches of the service.

Certainly one of the more prominent problems associated with that has traditionally been that of the Navy; the higher markup in exchanges, for example. Cigarettes are probably the primary example of that, but there are other products as well.

Secretary Pang, we also heard General Joy speak about recent plus-ups, the attempt by Congress to address that situation, comments alluded to the \$20 million POM that is scheduled to address it. Could you share with the Panel what the long-term objective is in this regard? Are you trying to adhere to a single pricing policy amongst all of the branches of the military? If so, how do you intend to achieve that and when?

Mr. PANG. Mr. Chairman, as you alluded to in asking the question, MWR programs have had a very long history, and I think it is fair to say that the MWR programs early on were very decentralized, locally managed programs. When we look at these programs we are faced with the dilemma of trying to satisfy local needs and let these programs be managed at the local level, while at the same time trying to centralize management in a prudent way so that we have more accountability for these programs and could do it more efficiently.

With regard to pricing, the pricing in the commissaries is standard. It is 5 percent over the cost of goods sold. With regard to the exchanges, the exchanges have traditionally set their own pricing. Therefore, the pricing is different in the Navy exchanges and the Army and Air Force exchanges. We have no initiative, at this time, to try to get down to the pricing of each good sold in the exchanges, but I think it is a fair question to ask whether or not we ought to be doing more in this area. Quite frankly, at this point in time we have no initiative to go much beyond where we are now, which is to allow the exchanges, as business operations, to set their own pricing with regard to product.

I might ask some of my colleagues here at the table what their views are on that, if they have any.

Mr. CHAMBLISS [presiding]. Thank you, sir. We will next recognize the gentleman from Alabama, Mr. Browder.

Mr. BROWDER. Thank you, Mr. Chairman. Secretary Pang, or any member of the witness panel who can answer this—and I hope that I did not miss this while I was out on the telephone. The program increases and decreases, I would like you to consider those in your request and discuss very briefly, how does this represent change in priority, if you had to characterize the change in priority in your request of decreases and increases?

Mr. PANG. Mr. Browder, maybe I can set the broad context and then turn it over to my colleagues. The appropriated funding of MWR programs has remained steady over the last several years at about \$1.4 billion a year. So we have maintained what I would consider to be a fairly robust funding of the MWR programs, especially

considering the fact that over this same period of time our forces have been downsizing.

With regard to the actual plus-ups and decreases in line items, I will have to defer on that to my colleagues.

Mr. BROWDER. Does anybody want to field that?

Admiral MARSH. Yes, sir, I can speak for the Navy and where we believe we are going. We feel we have got a very robust program and, like the Marine Corps, we have benefited fairly recently from a plus-up. Being a much larger service, we received more. In 1994 we got \$65 million which we used to our benefit. That has made our program much healthier. In fact, the last 2 years we have been generating profits in our MWR.

This year, as far as the total level of funding actually requested is down a little bit, but I think that will account for the closure of some of our bases and a general reevaluation of our priorities. That said, we still expect to have a profit in our MWR system.

General MEYER. Sir, for the Army, and I initially can speak for the Air Force, neither of us received a plus-up. But that is OK. The philosophy of the Department of Defense is to sort of equal the playing ground and it was appropriate what they did. For the Army, for fiscal year 1996 our program is funded for about \$154 million in MWR which does not account for the family programs. That is about a 92-percent solution.

The challenge there is between myself and the Army to gain that addition. If we receive that money from the Department of the Army we would probably reopen some facilities, we would increase our hours, and we would reduce our borrowed military manpower, where we put soldiers in facilities because we do not have the other manpower to handle that. Those would probably be the primary areas.

We would probably also improve the equipment in some of our facilities. It is not at a crisis stage. It is something that can be managed within the Army.

Mr. SISISKY. Will the gentleman yield for a minute?

Mr. BROWDER. Yes.

Mr. SISISKY. Did I hear you say, if you get the money from the Army?

General MEYER. Yes, sir.

Mr. SISISKY. Is it not a line item?

General MEYER. Yes, sir, we have a line item right now for \$154 million. That equates to about a 92-percent solution of what I really need to do this. So for reprogramming within the Army can fix that open.

Mr. SISISKY. I thought you meant the Army could use it for something else.

General MEYER. No, sir.

Mr. BROWDER. Secretary Pang, concerning the MWR overhead, there have been a good many suggestions about opportunity for savings. Why has the Department been so reluctant to take advantage of these opportunities? I cite specifically, at the request of the Army, the Logistics Management Institute assessed the advantages of management options for PX's and MWR and one option said that merging MWR and exchanges could save \$85 million to \$97.9 million per year just in overhead cost reductions alone.

Why have the DOD and Army been so reluctant to take advantage of these reductions so that savings could be passed on to the troops?

Mr. PANG. Mr. Browder, I think that we would support any reasonable effort to effect efficiencies in the program. I am somewhat familiar with this. I have not read the LMI report but I am familiar with it from briefings from the staff.

I know what we are faced with here. What we are faced with is taking an exchange service which is oriented to commercial resale activity, and considering using that structure which is pretty centralized to manage the local MWR programs which are very decentralized. These would be like boating activities, golf courses, and the like. I think there is kind of a general feeling that there might be some degradation in the benefit if you pursued some activities like that. I believe that is the general feeling.

With regard to the amount of money, in absolute amounts it is a considerable amount in overhead; \$250 million is lots of money. But in terms of the overall appropriation, that is about 16 percent. So what you are talking about is about 16-percent overhead in the running of the MWR activity.

Can there be further savings by cooperative efforts between the two? I think the answer to that is absolutely yes. I think there is resistance though, and I will let my colleagues address that, to the word merger. I think that is where we run into problems. I know that the LMI report was written with regard to the Army, so maybe my Army friend can answer the question.

General MEYER. Thank you, Secretary Pang.

Sir, the Army asked the Logistics Management Institute to analyze four options. Those options were status quo, enhanced status quo, development of a business command, and also put category C activities, which are our business activities, golf, bowling, et cetera under the purview of AAFES. We did not ask LMI for a recommendation. In the last 10 years several studies costing a lot of money have been done in this area, and every time we got a recommendation the institution seemed to shoot it down. This time we asked them to analyze the four options, give us the pros and cons, and let us take another approach.

We got that report, and if you pin down the Army, what we chose was enhanced status quo. It really turned out to be extremely beneficial. It was the linchpin that started us off into the creation of our vision and our strategic action plan. What we did was we took what we thought were the best of all alternatives that would be palatable and that would work, such as, we developed financial strategies where each installation commander has a benchmark on the wall. Your goal is to make 5 percent. Your goal is to take and put appropriated funds in your category A mission essential activities. Your goal in child care is such and such, and on down the line.

We took those alternatives and then we created our strategic plan. We discounted creating a stovepipe organization or a business command. We discounted putting things like golf and bowling under AAFES. AAFES does very well in running the retail outlets, but they do not have the experience in running golf courses or things like that. We have greater experience.

The benefit of the LMI study was that it enabled us to mark out our game plan for the next 5 years. We took the best of all of it. And, sir, if you had to pin a price tag, we estimate about a \$25 million savings will be realized by the enhanced status quo opportunity.

Mr. BROWDER. Mr. Chairman, I will yield back my time so that other members can ask their questions. But, I would like to come back to ask a few questions about some hotels. I also would not want to let this opportunity pass to ask our staff to grab hold of that term, "enhanced status quo". We could probably use that ourselves. We could work that for ourselves around here. [Laughter.] I yield back to the chairman.

Mr. MCHUGH. [presiding]. Speaking of great ideas, someone came up with the idea of no proxy voting last fall and that is why I had to run out. I appreciate your forbearance.

Mr. SISISKY. Would you like to change that now?

Mr. MCHUGH. No comment.

The practice of the committee is to recognize members as they appeared in the room at the time of the gavel, alternating parties. With that, I would recognize the vice chairman, Mr. Chambliss, for any questions he might have.

Mr. CHAMBLISS. Thank you, Mr. Chairman. Mr. Secretary, Admiral Marsh mentioned something in his statement that I want to focus on for a minute that I was not aware of. I am probably asking some questions here that may seem elementary. But he mentioned that he had about \$10.4 million, I believe, invested money that I assume is profits from the operation over some period of years. Is it the practice that each branch of the service handles their own investments, and are they invested in some sort of Government guaranteed accounts?

Mr. PANG. Yes, sir.

Mr. CHAMBLISS. I assume those moneys are to be used for long-range construction plans and that sort of thing. Does the Navy have a long-range plan for construction, the Army, Air Force, Marines? Does everybody have their own individual plan for use of those funds?

Mr. PANG. Yes, sir. In last year's Defense Authorization Act there was a requirement for the sweeping up of surplus cash and MWR money that were out in installations into a central facility. That has helped all of the military services better manage their capital investment accounts. That is my opinion.

With regard to investments, there was a story in the paper not long ago about investments in derivatives. In that particular instance, there was no loss on principal, but the investment did not make as much in interest as it could have if he had just put it in like a passbook account. So we looked into that and we have tightened up the investment policies. Now we have greater oversight, more centralized oversight over investments than we had before.

Mr. CHAMBLISS. Next, General Joy mentioned something regarding cooperatives initiatives that you are taking between the various branches. I am curious about the computer system that we have. Does everybody operate under the same computer system or does everybody have their own individual system? What do we do there?

Mr. PANG. I think the answer is that currently they all have their own systems. I know that there are discussions in the Resale Board with regard to whether or not we can move to greater co-operation and have a more standardized system. I know the answer at this point in time is that everybody has their own system. This has evolved over time so that is what you have today.

Mr. CHAMBLISS. Is there any study being done to determine whether or not there would be any advantage to consolidate those systems?

Mr. PANG. Could I ask Carolyn Becraft—she is my Deputy Assistant Secretary—to come up for a moment and respond to that?

Mr. CHAMBLISS. Sure.

Ms. BECRAFT. Thank you, sir. We worked with the Panel last year also. For all of our automated systems we require that all of the services have an open architecture system so that they can talk to each other and talk with industry. We put that requirement in writing, so any time they go out for any type of system they meet a centralized standard.

Most of the services are going to be upgrading their systems and are complying with this. They are required to comply with this. Much of the infrastructure, much of the investment that has gone into many of these MWR as well as exchange systems, have gone to updating their management information systems to keep them current. So we feel we are well on the way to that. Thank you.

Mr. CHAMBLISS. That is all I have.

Mr. MCHUGH. Thank you.

Mr. Sisisky.

Mr. SISISKY. Thank you, Mr. Chairman. I appreciate your recognizing me before. I just want to make a correction. I have never been a member of the Panel here. I have been here probably longer than anybody here. But I have had a connection to the Panel, to be very honest with you.

In saying that, I want to recognize one individual who is in our audience who served long and hard on this committee as a professional staff member on behalf the MWR and the troops. I used to go to him when I had a problem with MWR, and that was the right place to go. He is Will Cofer who is sitting back there and who has served for a very long time on our committee.

I am still interested in the chairman's question. I did not ask the question. He asked the question before I asked it. Tell me what the Executive Resale Board does. Can anybody explain that?

Mr. PANG. Mr. Sisisky, the Executive Resale Board does not make policy. You get the people who manage the MWR programs and the resale programs, and they get together and they talk about operations to see whether or not they can combine their efforts to operate more efficiently. So, it is looking at efficiencies, looking at ways of doing business better.

Mr. SISISKY. Coming back to the chairman, that does not set policy as it relates to different products the commissary may sell, the PX may sell?

Mr. PANG. No, sir.

Mr. SISISKY. In the Navy, does the commissary sell tobacco products?

Admiral MARSH. Admiral Kavanaugh, who deals with that, will be here next week. Not being a smoker, I have never bought any tobacco in the commissary, but I do not believe they do.

Mr. SISISKY. With the downsizing of 1 million people, I think I understand the pressures that are on the system. There is no question that the pressure is on the system. I watched it in Desert Storm, particularly in the Hampton Roads area when bases were advertising for members in their club because everybody went to sea. I knew what the problem was. I said, just do not advertise the fact that you are doing that.

I know the pressure that is on you, but the purpose of the exchange service and the commissary service is to give the service person the lowest price and the best product possible. I worry that we do not always do that. I do not know if you have surveys that check on the outside pricing. You wonder why somebody goes outside the gate. You said it. Somewhere along the line there must be a good reason for people to go out of the gate, and it may be because of pricing.

I always viewed the running of the exchange service and the commissary to sell merchandise at the lowest price to a person who is in the service. Is that a fair assumption? The side benefits, of course, are to gather some profit. I am never against profit—to build the things and to run the things that are necessary for quality of life issues.

I do not want to get into a point that we raise our prices to build buildings and other things to the detriment of our service people. This is something that they are used to and demand. I know how many letters I got the minute the rumors went out that we may close the commissary service. I went to the Secretary of Defense and there was nothing in his mind to do it. As a matter of fact, he reiterated his statement to keep it open.

This is something that service people expect. It is part of their compensation, particularly those who are overseas. So I just want to be sure that we do not get in these boards. We have antitrust laws about fixing prices and other things. I do not know whether it works in the service or not, but I think we need to be careful. I am not saying that you are doing it or you are not doing it, but certainly it is something that we need to look at.

Mr. Chairman, I look forward to working on this Panel. I am one who spent most of his business life selling to the commissary service and the exchange service. I am not doing it anymore. I would have been on this Panel 10 years ago but I was still in business. Now I am out of business, and I am just a poor Federal employee looking to take care of my service people.

And I want to take care of my service people. I have in my district a lot of people who are in the service and serving their country. I want to be sure that they are taken care of, and you people are the ones who really set the policy. I just want to be sure that the policy is to the benefit of that person who is in the service.

Colonel RICHARDS. Mr. Sisisky, if I could bring together a line of questioning you and Mr. Browder had earlier. That was overhead and the Executive Resale Board. The Executive Resale Board works very hard to find cooperative ventures on how we can work

together to do just what Mr. Browder suggested, and that is to reduce overhead.

As a matter of fact, we met 3 weeks ago for a 3-day strategic planning session and identified 50 different areas where we feel between the service MWR programs and, in some cases, the exchanges can work together to try to reduce overhead cost by collaborative efforts. We see great value and potential in that. Some are already working. We want to exploit those. Others may be more difficult to work, but we see great potential value in doing just what Mr. Browder suggested. Again, that is, reduce overhead cost.

Mr. SISISKY. That is great.

General JOY. Sir, in regard to pricing and what I was referring to as far as the competition. First, I know I can speak for General Swarts, the AAFES commander, and Admiral Kavanaugh, the NEXCOM commander. We spend a great deal of time in the local market where our exchanges are located comparing prices with our competition. We remain as competitive as we can.

What I was referring to, the primary competition outside the gate that is causing us great difficulty—I will not name them by name, but it is the category killers.

Mr. SISISKY. I know what you are talking about.

General JOY. In the electronics area, in toys, in sporting goods, in hardware and those type things. The point I would make is that we are still the best game in town as far as across the store. But these category killers, we have extreme competition in those areas.

Mr. BROWDER. Would the gentleman yield?

Mr. SISISKY. Sure.

Mr. BROWDER. Colonel Richards, you mentioned 50 areas. Could you provide those to the panel?

[The following information was received for the record:]

50 AREAS

The Department has been pursuing a number of cooperative initiatives to reduce operating costs in order to lower prices and improve benefits to the military community. A number of these have been active for a number of years and were reported to the Committee by OASD letter 24 Feb 1994. These were considered among the 50 initiatives mentioned during the hearing and are included in this insert. In addition to these, this process has been strengthened by the involvement of the Department of Defense Executive Resale Board. The Board members have expanded the previous effort, and broadened the scope of the participation to include all interested parties. Active efforts involving some or all member organizations are also listed below. Finally, the Board members have also made a commitment to explore possible cooperative efforts in the general areas of acquisition, human resources, support systems and business operation. As specific initiatives are identified, they will be studied to determine their feasibility and applicability, and made available to member organizations for their consideration.

COOPERATIVE EFFORTS PREVIOUSLY REPORTED

Accounting and finance report formats: Common report format for consolidated financial statements; common chart of accounts; and comparable accounting processes.

Data processing: Develop and test shared data; standard interchange formats; open cooperative data processing; use of industry standards for software; meet commercial and retail ADP open architecture hardware standard; and use standard universal product codes for resale merchandise.

Cooperative ventures in the distribution of high volume merchandise.

Cross merchandising of private label products.

Cross merchandising of in-house food concepts.

Use of shared services: Quality assurance testing; deferred payment plan; video tape rental program; and mail order catalog service.

Cross utilize building design and construction processes.

COOPERATIVE EFFORTS IDENTIFIED BY THE DOD RESALE BOARD CURRENTLY BEING WORKED

Business efficiencies: Exchange reading materials in commissaries; consolidated bakery and ice cream production in Europe; consolidated purchase and distribution of soft drinks in Europe; cross utilization of excess warehouse space and equipment; joint one-time buys; distribution replenishment; and joint procurement efforts.

Administrative and support system efficiencies: Shared training to reduce duplicated efforts; cross utilization of customer service surveys; consolidated printing of advertisement materials; and shared satellite TV capability.

Colonel RICHARDS. Certainly, we will provide those for the record, sir.

Mr. BROWDER. Thank you.

Mr. MCHUGH. Yield back?

Mr. SISISKY. Yes.

Mr. MCHUGH. Before I recognize the next speaker, let me just very briefly associate myself with what I understood the comments of Mr. Browder were while I was out of the room. Obviously, the question of overhead is an enormous one. LMI analyses and others show potential savings, and I think it is incumbent upon all of us to try to work together to try to realize as much savings on overhead as we possibly can. I think that is going to be, already has been, and will continue to be, an area of great interest on the part of this Panel.

Recognizing now the Members as they appeared in the room after the dropping of the gavel, it's my pleasure to recognize Mr. Ortiz.

Mr. ORTIZ. Thank you, Mr. Chairman. I think that in the long run, and through no fault of anybody here, servicemen and women have lost millions of dollars of their money. As we look at base closure—I visited some bases where facilities were shut down and closed—can you tell me—like I say, this was no fault of your own because this was when treaties were being signed by the State Department—do you have an estimate as to how much money we have lost in facilities that MWR has built because you were not consulted when these treaties were made? Do you have any idea?

Mr. PANG. Mr. Ortiz, I do not have the exact dollar amount, but I will research that and provide it for the record. I know it is a fact that for our overseas activities where we are governed by status of forces agreements, we have not recovered a penny.

[The following information was received for the record:]

Since the start of the restructuring and downsizing of the Armed Forces, we estimate that the value of capital write-off of NAF investments in facility construction and improvements is:

Air Force MWR—\$37.2 million.

Army MWR—\$69.0 million.

Navy MWR—\$3.9 million.

The Marine Corps MWR Support Activity has not written off any MWR capital assets overseas as a result of restructuring and downsizing.

Mr. ORTIZ. How about now that we are looking at another base closure—and I know that in many instances a lot of these facilities will be turned back to communities.

Mr. PANG. Yes, sir.

Mr. ORTIZ. I know that a lot of these facilities, and I am talking about MWR facilities, were built with soldiers' moneys. Are we going to be able to recover some of those moneys?

Mr. PANG. Yes, sir. We can go to the BRAC accounts and get moneys for these facilities. For example, DECA recently got \$20 million. I believe the exchange service got about \$20 million, and the MWR accounts got back about \$30 million. So there is recovery, but it is only for those facilities that are in our country. We do not have any control over those that are overseas.

Mr. ORTIZ. There is a good possibility that we might continue, not as extensive as we did before, building in foreign countries as things change. Are we making sure now that you all will be consulted to see that we get that money back in case we have to turn those facilities, like—it hurt me when I went to Spain and other countries and I saw the beautiful facilities that had been built there with soldiers' moneys and we had to give them away. Maybe you just have not been consulted.

Mr. PANG. I think, Mr. Ortiz, this is something we would have to pursue with the State Department.

Mr. ORTIZ. Maybe we can work something like that because—I will name Mr. Sisisky to work on that. But now that everybody is talking about merging and maybe saving money, is this the appropriate time, or is it premature seeing that we are going through a Base Closure Commission now and there is a good possibility there will be another one coming up within the next 3 or 4 years? Any volunteers?

[No response.]

Mr. ORTIZ. We have had some witnesses on other issues that we discussed and some of them said they are beginning to see the light and now they know what to expect. But when we are talking about soldiers' money, are we premature or can we see the light and say, maybe we can do this or that without really knowing which bases are going to shut down? Not only in this round, but in the next coming round.

Mr. PANG. Mr. Ortiz, I think we need to take into account the infrastructure that is going to be remaining. That is very important.

With regard to mergers, as we get smaller I think that in principle, as long as the benefit itself is not hurt, those are initiatives that we might want to pursue. There is a great deal of concern that in doing a merger somehow or another the benefits are going to be negatively affected.

For example, there was some discussion about merging the commissaries and the exchanges. There was great concern in the Pentagon that if you did something like that, you could not preserve the commissary benefit as it is known today. In other words, there would be a degradation in the benefit. And, there is great concern with an erosion of benefits for our men and women in uniform and their families at this time, especially with the stresses of the drawdown and with the changing or evolving mission that we are dealing with in the building.

Mr. ORTIZ. Let me say that I have been a member of this Panel for many years, and I have had the opportunity to work with you. You have done an outstanding job with what we have given you.

We have an outstanding chairman and members of this Panel. I know that both you and this Panel would like to do what is best for our service people, and I know that we are going to work very close together. We have people here who have their heart in the right place.

Thank you for a great job that I know you will continue to do.

Mr. PANG. Mr. Ortiz, I said in my opening statement, and I meant every single word, that the support that this Panel has given to our men and women in uniform, especially during the period of the drawdown, was just marvelous. Without the support that you gave us we would not be in the condition that we are in today. People knew that the Congress, the administration, and our military leaders were concerned about their welfare.

We were preoccupied at the early phases of the drawdown about moving people out of the force without creating a disaster. You know, having people leave who are uncles, brothers, and some are going to be fathers of the people we are going to recruit in the future. We do not want them to leave the military with a sour taste in their mouth. I think we did a good job in that area. We also need to take care of the people who remain behind. Those people who took the risk, knowing that the forces were coming down, and stood with us. So, we are very concerned about that and that is why Secretary Perry has made quality of life his top priority in the personnel area. We look forward to working with you, sir.

Mr. ORTIZ. Mr. Secretary, thank you very much. I commit myself to working with the chairman and the ranking member, Mr. Browder. I know we will work together. Thank you.

Mr. MCHUGH. Thank the gentleman for his insightful and kind comments.

The gentleman from Oklahoma, Mr. Watts.

Mr. WATTS. Thank you, Mr. Chairman.

Mr. Pang, first of all let me say I appreciate what MWR does. I have been on the facilities, on the grounds on the facilities in the Fourth District of Oklahoma. We have Altus Air Force Base and Fort Sill Army Post. They are quite proud of their recreation facilities and what you all do in the area of MWR. I am concerned, however, that there continues to be a disparity among the armed services over the treatment of their people. It appears that despite congressional increases in appropriations the Navy continues to come up short on its funding, and this policy has the practical effect of having the Navy keep cigarettes out of its commissaries so that sailors can only buy them in exchanges. To make matters worse, sailors also have to pay a higher markup in exchanges for these products than their counterparts in the Army and the Air Force.

Military people make the same amount of money regardless of the branch of the armed service to which they are assigned. Therefore, do we not need a consistent policy throughout for pricing items? How do you reconcile this pricing disparity, and could you share with me how we might be able to address that?

Mr. PANG. I think it is fair to say that with regard to commissary pricing we have a standard policy and have had it for a long time. The prices we charge patrons are 5 percent over cost. There is a 5-percent surcharge.

With regard to the exchanges, there is a long history of the exchanges establishing their own pricing for the goods they sell. So you can go to a Navy exchange, for example, and buy a tube of toothpaste at a price different than it would be in the Army and Air Force exchange.

The exchange profits are a tremendous source of income to MWR. I think that that gets to your question with regard to the issue of cigarettes. Cigarettes, by policy in the Navy, are not sold in Navy commissaries, for the most part. I think there are some exceptions. They are sold in the exchanges. All of the exchanges sell them, and all of the other commissaries sell them.

I think part of the rationale for the Navy's policy is that the Navy has a very aggressive program on smoking cessation. The other reason is because the cigarettes that are sold in Navy exchanges are sold at a rate higher than you would sell them in the commissaries, and those profits from the Navy exchange go to support Navy morale, welfare, and recreation programs.

I am explaining the current situation to you with regard to whether or not we intend to change that. At this point in time, we have no plan to get into the details of the pricing as it is carried out by the various exchanges.

Mr. WATTS. I am not suggesting that you change it. When you consider that everybody is making the same amount, regardless of what branch of the service you are in, I am curious why there is not a consistent pricing policy. I think you have articulated why there is, but I was wondering why it is like that if everybody is making the same amount of money.

Mr. PANG. I think it is because the exchange services are retail activities and they have to compete with the market. We allow them great latitude in establishing pricing. We have not entered into a central pricing policy. I think it is a valid question for you to ask. This is something that, obviously, I will explore when I get back after the hearing. But at this point in time, I know of no plan within the Pentagon to come up with a standard pricing policy for goods that are sold in the exchanges.

Mr. WATTS. Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

Mr. MCHUGH. I thank the gentleman.

The Chair now recognizes the gentleman from Virginia, the chairman of the Subcommittee on Readiness and a long time Panel member, Mr. Bateman.

Mr. BATEMAN. Thank you, Mr. Chairman, and welcome to our witness panel. It is always a pleasure to have them here and for them to catch us up on what is happening in the world of morale, welfare and recreation.

The matter of base closures has come up as it related to nonappropriated fund assets. I would like to join in those who have a concern about what happens to the facilities bought and paid for with soldiers', and sailors', and airmen's money as a result of that process, especially the horror of what they experience when bases happen to be foreign bases.

There is a particular category that is of particular interest to me at this time. Another Panel of the National Security Committee that I chair has jurisdiction over the Panama Canal. In the Canal

Zone, I believe there are some MWR facilities, nonappropriated fund facilities, and under the agreement with Panama we are to turn over all of our military facilities in Panama between now and 1999.

Could someone get me an inventory of all of the nonappropriated fund facilities that are in Panama in order that we may explore what can and cannot be done to protect the interest of our military personnel in those facilities?

[The following information was received for the record:]

Navy does not have any MWR facilities in Panama that were constructed with nonappropriated funds. The construction funding for Navy's MWR facilities at Naval Station, Panama Canal came from resources other than nonappropriated funds. However, nonappropriated funds have been used to support the repair of MWR facilities. With the exception of the two listed below, totalling \$75 thousand, all of these repairs will have been fully appreciated by December 1999.

(In thousands of dollars)

Year	Project	Cost	Book Value
1993	All Hands Club Renovation	86	46
1993	Marina Berthing	57	29
		143	75

Question. Could someone get me an inventory of all of the nonappropriated fund facilities that are in Panama in order that we may explore what can and cannot be done to protect the interest of our military personnel in those facilities.

Answer. At the end of FY94, Marine Corps Exchange facilities located in Panama were transferred to AAFES. In June 1995, our club operation was closed in conjunction with the closing of the Barracks.

The other thing that I would like to ask about is, the last time I saw anything on the subject it was contemplated that we were going to give up certain recreational facilities in Germany and the Germans would fund the rehabilitation of the facilities at Berchtesgarden. I noticed you stated, General Meyer, in your prepared statement that the Germans had concluded not to go forward with that arrangement?

General MEYER. Sir, in 1991 the Secretary of the Army with the concurrence of both panels decided that we only need two recreation centers in Europe. Berchtesgarden would close, and Chiemsee and Garmisch would downsize. In 1993, the Germans came to us and said, if you do not mind, we would like for you to keep Berchtesgarden open, close Chiemsee, and we will give you the amount of money that you put into Chiemsee to refurbish your facilities in Berchtesgarden.

Everything was going along just fine, and at about the 99th hour the Germans could not come up with the money. It is somewhere around \$20 million. Those facilities needed to be upgraded desperately. It got to General Maddux, the CINC, the commander in Europe, got involved with the highest levels of German defense and the bottom line came out, they could not come up with the money. So we said, thank you, and we decided to close Berchtesgarden like the panel originally agreed to do and to open Chiemsee back up.

There is some advantage to that. We have done some surveys and found that we really have a summer opportunity in an Armed Forces recreation center as well as Garmisch. It has only been in mothballs for about 10 months. The furniture is still there, so we

intend to open the campgrounds in June and the facility in November. That is the bottom line.

Mr. BATEMAN. So facility-wise, and in terms of giving variety to the program, we have not lost in the transaction?

General MEYER. No, sir, we have not lost. And probably with the current downsizing, we have gained in the soldier's desires.

Mr. BATEMAN. Returning to Panama, and not knowing what the facilities are and hoping to see them next month. You might give some thought to whether or not—given the climate, the geography, and the other considerations—that would be an economical recreational facility for the armed services in the event that it could be worked out, as opposed to just turning it over to the Panamanians.

General MEYER. All right, sir.

Mr. BATEMAN. The other question is, both from the hearings that my Subcommittee on Military Readiness has been holding as well as from discussions with military personnel, the high personnel tempo that we have experienced over the last 2 or more years has obviously produced a great deal of stress and pressure on military personnel, especially in those units which are more frequently, and almost regularly deployed.

An organization such as the 7th Transportation Group, which is stationed or operates out of Fort Eustis in my district, comes to mind. These people have literally spent as much or more time away from home for unpredictable periods of time than they have spent at home. There is a great deal of stress generated on families.

My impression is that the command has been doing a very good job of trying to provide counseling and family support for the personnel of these units. Is the Army working, or are all of the services really working, at family support programs for these frequent and extended deployed units?

Mr. PANG. Mr. Bateman, the answer is yes. We are doing two things. One, we are concerned about the families of the high-deployers. But I think that the bigger initiative that we are undertaking with the Joint Chiefs of Staff is to look at these high deploying activities like A-10s, AWACS, and the like, to see whether or not we ought to change the manning pattern for them, and to look at more innovative ways of using assets. This is really an important thing for us to do.

I would mention that 9 percent of our forces are deployed at any one time on what we call nonroutine deployment. So, the number is not real high, but it falls upon the soldiers of relatively small pockets of people. This has come to our attention and we are working very hard on it. The J-1, Admiral Tracy of the Joint Staff is leading a working group within the Defense Department with all of the services participating to work on that issue and come up with a solution.

Mr. BATEMAN. I think it is certainly one of your most telling priorities and challenges.

I have one last brief question, and this will take only a moment. Do we have pending capital improvement projects and requests that are before the Panel for oversight or review that have not been acted on?

Mr. PANG. I believe you have acted on all of our requests, sir. We do not have any pending, I do not believe.

Mr. BATEMAN. Thank you.

Mr. BROWDER. If the gentleman will yield? I think we are getting mixed signals.

Mr. PANG. I am told that we have a number that are pending. Let me ask Carolyn Becraft of my staff.

Ms. BECRAFT. There are a few projects that are still pending that we have not had a release on from this Panel.

Mr. MCHUGH. We are attempting to move upon those as expeditiously and as judiciously as we can.

We have been joined by yet another gentleman from Virginia. Mr. Owen Pickett is here and I would like to recognize him for any comments and/or questions he might have.

Mr. PICKETT. Mr. Chairman, I apologize for being late. I did have a conflict this afternoon, but I know that you all have done your usual fine job, and I know our Panel has done its usual fine job. It is a pleasure to be here, and I do not have any questions at this time.

Mr. MCHUGH. I thank the gentleman. We understand the scheduling and his presence here at all is much appreciated.

The Chair is going to pass on his next round. I know Mr. Browder has a question or two he would like to follow up on. So, to accommodate him, I would be happy to yield to him at this time.

Mr. BROWDER. Thank you, Mr. Chairman. General Meyer, to what extent are MWR activities using military personnel to fill staffing positions?

General MEYER. Sir, I would probably more accurately be able to get you the exact number for the record.

Mr. BROWDER. Could you do that and also tell us what positions?

General MEYER. Yes, sir, I will.

[The following information was received for the record:]

BORROWED MILITARY MANPOWER

Downsizing initiatives and budget reductions are requiring commanders to look to other ways of accomplishing work. Therefore it is understood that some soldiers are needed occasionally to perform work in support functions, such as staffing MWR positions. The Army has specific manpower management policies in place regarding how soldiers may be used to perform peacetime work that is normally assigned to civilian employees or contracted out.

In recent years, it has not been practical or cost effective to collect data in the detail requested. More detailed reporting would require distinction between myriad types of duties such as one-time taskings, recurring tasks of a few hours duration, and special duty assignments over an extended period.

Mr. BROWDER. I think Mr. Bateman has asked a couple of questions about Berchtesgarden. I would like to ask you about Orlando. I have seen your report. You call Orlando an unqualified success with soldiers and families. But then there is a followup, that financial performance did not meet expectations as yet. That sounds like a recipe for disaster.

General MEYER. Yes, sir, we have a challenge there, but I think I can articulate it for you. We advantaged the junior enlisted soldier. That is a sergeant to private only pays \$49 a night. A sergeant major or colonel pays \$92 a night, and the other ranks are graduated. When Disney ran the hotel they charged a guest \$149 a night. When we did our analysis before we leased the hotel about

2½ years ago, we did a performa looking at our other Armed Forces recreational centers, as well as an outside consultant. We estimated at that time that 20 percent of the hotel would be filled with junior soldiers and 20 percent would be filled with senior soldiers, and we would break even.

We were a little bit off in our estimate. Actually, sir, it is about 38 percent is being filled with junior soldiers at \$49 a night and only 3 percent with senior soldiers at \$92 a night. Instead of making \$1 million our first year, we lost \$1 million. The challenge we have now is that we are leasing the facility. Consequently, we are paying rent. Under that same scenario, and if nothing else changed and we owned that facility, instead of losing \$1 million we would have made \$1.5 million and not had to disadvantage that \$49 rate for that junior soldier.

The current situation is this. We have negotiated with Disney on a buy-out price. The Army Board of Directors and the Secretariat and the leadership is looking at that option. We have hired an outside Big Six auditing firm, Deloitte Touche, to analyze are we getting a fair deal from Disney, can we pay for it the way we say we are going to pay for it, 75/25 in-house kind of thing, and can the Army MWR bank account sustain the purchase of that facility? We hope to have the results by April 15. At that time, the Army leadership will analyze those results and maybe come forth to this Panel, as well as the Senate Panel, on a request to buy.

But right now we have to buy it or get out because we cannot sustain the rent payment. We knew at the beginning that this rent payment was going to be steep, and it is the lowest in the first 3 years.

If you talk about satisfaction to the customer, it is off the chart and a dream for any hotelier. The comment cards are unbelievable. We filled that hotel last year at 94 percent. We are currently running a 98-percent occupancy rate. We have 50,000 unmet room demand nights. We have 23,000 soldiers on a waiting list, we have referred 14,000 rooms to other Disney hotels, and we have received \$109,000 because of that.

The bottom line is, it is an unqualified success. But we want to try and keep it to where that junior soldier is advantaged. We did a survey; 55 percent of the occupants said that if it had not been for the price, they could not afford to have come to Disney.

Mr. BROWDER. General, it is intriguing, the conflict. The reason it is such a success story is the low price?

General MEYER. Yes, sir.

Mr. BROWDER. Yet, we are losing money.

General MEYER. Yes, sir; because we are paying rent.

Mr. BROWDER. So how do we call that such a success?

General MEYER. Sir, because we are paying rent. In all our other AFRC facilities, Hale Koa in Hawaii, Garmisch and Berchtesgarden, Chiemsee and Dragon Hill in Korea, we own those facilities. If we did not pay that rent, and we owned it, we would make money and we would be able to advantage that junior soldier. One of the Army goals is to make it affordable; to give that soldier an opportunity to go somewhere besides that installation. You can only go to your recreational facility so many times on a base until

it gets old. This gives them an opportunity to do something different at an affordable price.

Mr. BROWDER. The people who are estimating that if we bought the property we could really do a great deal, are they the same people who did the first estimates?

General MEYER. Great question, sir; and the answer is yes. But I have got to tell you, sir; this time we are not leaving it to chance. The Deloitte Touche auditing firm will sustain if our projections are right. And we will take a little gamble here. The initial—and I say initial underlined about 100 times—review from Deloitte Touche is that our performa figures on that \$1 million loss, \$1.5 million gain, is going to be substantiated at the end. We will know in April.

But, you are right. The same folks who did it are the same projectors.

Mr. BROWDER. As you know, I have requested a briefing on Berchtesgarden and Orlando, and also on the Thayer Hotel. Regarding the Thayer Hotel, I still have not comprehended what kind of animal that is. I would like a briefing because, as I understand it, we own it but the person who is going to do the renovations wants approval for \$25 million to renovate it and then that person would own it for say 99 years. I think we are being asked to accept responsibility, or to fund the full \$25 million. Plus, if it does not work, to buy out the hotel. As I said, I have not figured out—and that is because of my inexperience perhaps—what kind of animal this is. But, I would like a briefing on those three hotels before we proceed to approve that action.

General MEYER. Sir, we would be glad to bring you up to speed. I have to say regarding the Hotel Thayer, every organization has had a challenge in its life and the Hotel Thayer has been around for about 5 years, and this sucker just does not seem to go away. Every time we think we have it fixed, we get a new wrinkle. Mr. Ortiz lived with this thing for quite a while, and most of these members are new. If I can just say one thing, the facts that you articulated are in the ballpark, but they can be explained in a different way.

The bottom line, sir, is that that hotel is a 69-year-old hotel and it is in great need of repair. It has made money over the years, but never enough money to capitalize itself the way you should in a hotel. But there is a need for that hotel in that area. If the Army wanted to fix that hotel up, it would cost us about \$25 million in nonappropriated funds, and the only thing that \$25 million would do is fix the structural and safety problems in the hotel. It would not enlarge the rooms, and some of them are so small you have to crawl across the bed to get to the other side. The kitchen is in the basement so you have to carry the food up. We have struggled with this forever.

But on a cost-benefit analysis, you do not get a good return on your investment because we are just fixing it up to put us in the same position. So we have asked an outside developer to look at that, and that is what I will come explain to you, and anybody else on the committee, because we do have some challenges here.

Mr. BROWDER. Mr. Chairman, I do not want to prolong the hearing needlessly, but one last question. This is a softball, gentlemen.

I think it would be wrong for us not to give you a chance to give an answer to this question since the chairman and the ranking member are new to this Panel. I think it has been stated that we are estimating \$295 per military person for these kinds of activities. Why shouldn't we just increase the military person's pay by \$295 and let them go out and spend it wherever they want to and not have any of these activities? You know, let them go downtown or go wherever they wanted to.

Mr. MCHUGH. Mr. Secretary, do you want to take that softball?

Mr. BROWDER. I considered that a softball.

Mr. PANG. Let me just explain the \$295 and then maybe come back and answer the question. I am not trying to be evasive, but the \$295 amount was an amount that we established as a floor. Quite frankly, the reason we established it as a floor is because the Navy had to plus-up its MWR account and then we also plused-up the Marine Corps MWR account. So that basically our junior enlisted people and single people could get the kind of recreation that they really deserve.

These are to fund activities that are Category A activities which are mission support activities: gyms, unit sports programs and the like, because physical fitness is really crucial to maintaining the readiness of the force. They also have the benefit of fostering unit cohesion because you have a lot of teamwork.

I guess the answer to your question is that, in the military, I guess like it or not, we have this big brother syndrome. We believe that we are better able to provide the kind of activities on post for our people; do not charge them, let them come in and play basketball or football, and do the kinds of things to stay fit, and to provide an atmosphere where you can enhance unit cohesion and camaraderie.

So we feel that we are able to do that, and we would prefer to do it.

Mr. BROWDER. Do you think those activities would not be offered if big brother did not do it?

Mr. PANG. I think if we gave them the money, these are moneys that would go into sustaining the facilities and so forth.

Mr. MCHUGH. If the gentleman will yield?

Mr. BROWDER. Yes.

Mr. MCHUGH. I would put a little spin on this softball. The \$295 certainly from the Marine and the Navy perspective is a plus. I do not want to sound as though I am criticizing it, but let me play devil's advocate for a moment. Is there any concern in the Pentagon that by setting that \$295 you may, in fact, draw down the efforts that have been traditionally higher within the Army and particularly the Air Force?

Mr. PANG. Mr. Chairman, I do not think that is the case. This was to pull up two services that were below. But in fairness to those two services, I think the reason that the investment was lower than the other services is because of the way they operate. What we are talking about are the sea services and for a period of time on deployments and the like, home is aboard ship. For Marines, home is aboard an amphibious vessel. So the investments were not made because of that.

Mr. MCHUGH. I understand there are some very unique challenges there, and that was not really the intent of my question. I guess what you are saying is, you feel certain, either by directive or understanding, that the Air Force and the Army will continue their higher than \$295 effort.

Mr. PANG. Yes, sir. To get back to Mr. Browder's question, quite frankly, the installation is our community for the military. So the gyms, the libraries, the theaters and the like, this is where our soldiers, sailors, airmen, and marines go during off-duty time.

Mr. BROWDER. I do not disagree with you, but I did want to ask the question.

General JOY. Sir, could I elaborate on that? I think Mr. Pang touched on a very important point. A lot of that \$295 goes to what we consider mission-essential activities. The point I would make, and it goes back to Mr. Bateman's comment about PERSTEMP and this type of thing, is that in the Marine Corps our gymnasiums, fitness centers, libraries, theaters, et cetera, not only provide the recreational support for the marine and his family, but they also prepare that individual for going into combat. Speaking for our junior marines, if we provide them \$295, what they would spend that on outside the gate—

Mr. BROWDER. It would not be at the library.

General JOY. They are probably not going to the fitness center and the library. So it is very, very important to us.

Also, when our marines make these many deployments that Mr. Bateman was talking to, it provides a good program for the dependents who stay behind.

Colonel RICHARDS. If I could address one aspect. We were talking about the \$295 and I would like to shift to another issue you brought up, and that was, why not just pay the troops that \$295 and let them go off base and get that? I think that really downplays, or does not recognize, that we are a unique profession, and that our people do not wear this uniform to make money. They wear it because they proudly serve their Nation. They wear it recognizing that there will be certain sacrifices required of them, and all they ask in return is that those sacrifices be respected and appreciated by the American public, by Congress, and their leadership, and that we provide them a certain quality of life to go along with those sacrifices.

We are the only profession that not only works together as a team, but we play together as a team, and we live together as a team. I fear that on the approach that you suggested, if you do that you start down a long road that you may not recover from in a subtle change from a profession, the attitude of our people as a profession and a very honored profession, to one of merely an occupation. And we are not like IBM or General Motors.

Mr. BROWDER. I yield back my time to the chairman.

Mr. MCHUGH. Let me just bounce around and ask what I hope will be some quick clean-up questions. Back to General Meyer and discussing Shades of Green. Are Army personnel the only branch of the service that uses that facility?

General MEYER. No, sir, any DOD ID card carrier can go there.

Mr. MCHUGH. Is there any prioritization given to Army personnel on reservations or is it first-come, first-serve?

General MEYER. Right now it is first come, first serve for any service. In fact, sir, in the latest statistics you will find that the Air Force is one percentage point occupancy higher than the Army. I guess they get more free time.

Colonel RICHARDS. That is because we are more efficient. [Laughter.]

Mr. MCHUGH. Is that not the policy that is adhered to throughout all of your hotel facilities?

General MEYER. Yes, sir, it is.

Mr. MCHUGH. These are not Army-exclusive.

General MEYER. We just seem to be the guru of AFRCs, but we open it up to every service.

Mr. MCHUGH. The question I have is, why are you the guru totally? Why is there not some interservicing effort on financing here?

General MEYER. The straightforward answer is, sir; every service seems to have its priorities and the Army has sort of taken on a culture, way back when, in this AFRC arena. We found this to be very beneficial to our soldiers who are in various geographic locations. I do not think the other services have quite seen fit to do that. They have decided to spend their money in a different direction.

We have been very fortunate that we have been able to afford these facilities. For example, in Hawaii our recreation machine revenue was able to award \$110 million for a second wing of that facility. And because where we are located all services are, it would just be a disadvantage. For example, the Air Force lets our soldiers go on their golf courses and vice versa. So we have just sort of taken that philosophy that we will run it, we will operate it, and we will open it up to everybody.

Mr. MCHUGH. I sure do not want to disrupt the two-centuries old spirit of camaraderie amongst some of the services. I know the Air Force has not been there for quite that long. But perhaps in this new day where you are experiencing, as you say, certain challenges, and Shades of Green and Berchtesgarden and others, maybe we ought to revisit that issue. That is for another day.

Secretary Pang, in some of your comments you were talking about a new strategy for investments, and that you have begun to develop an oversight structure. Has that been finalized?

Mr. PANG. We have finalized it in the sense that we have gone out to the military services and told them what we expect with regard to investments. We still have got more work to do.

Mr. MCHUGH. Does that preclude derivatives in the future, or how are you approaching that issue?

Mr. PANG. I think the overarching guidance that we would issue is that there should be no investment of any kind that would result in a zero interest rate. In other words, I do not think any of our investment strategies now result in a loss in principal.

Mr. MCHUGH. That was going to be my next question, is the example you were speaking about the Army situation?

Mr. PANG. Yes, sir.

Mr. MCHUGH. There was no loss of principal there; is that correct?

Mr. PANG. There was no loss of principal.

Mr. MCHUGH. Thank you. Obviously, this is the age of credit and the services are not exempt from that trend. People not only come to enjoy it but, in many instances, they come to expect it. I know that the issuance of credit is a big one in these program areas. I know at Fort Hood the Army has the Esprit card that they are test driving, and most of the PX systems offer credit. That is in addition, of course, to VISA and AMEX and all the other credit cards available commercially.

Is there any kind of policy that is either instituted at the service level or through the Pentagon that tries to ensure that our men and women in uniform do not get too far extended with all of these programs growing up?

Mr. PANG. Yes, sir. By the end of this year, December of this year, we will require credit checks on all people who get credit cards. We also have instituted an annual review of credit programs, and we are examining the feasibility of consolidating credit.

Mr. MCHUGH. So how are you going to do that amongst the various services? Are they required to report credit extensions to some centralized bank?

Mr. PANG. We have not determined how we are going to do it yet. This is something that we are looking into. There are separate cards at this point in time so the question is, can we consolidate so that all of the different cards that we have, and have just one credit card. We have been working with our comptroller on this matter, so it is not just us and personnel and readiness.

Mr. MCHUGH. I appreciate that. Obviously, we could continue for a long time. But you gentlemen have been very gracious with your time and we do appreciate that. I know the hour is getting relatively late so I would say that we will, in all likelihood, submit some other questions for the record and I would encourage and invite all other members to join us, if they would choose to do so.

I would also note that, without objection, I would file a statement submitted for the record as submitted by the Air Force Sergeants Association. Hearing no objection, that will be so ordered.

[The statement of the Air Force Sergeants Association follows:]



STATEMENT

BY

CHIEF MASTER SERGEANT JAMES E. LOKOVIC, USAF (RET.)

DIRECTOR, MILITARY AND GOVERNMENT RELATIONS

AIR FORCE SERGEANTS ASSOCIATION

BEFORE THE HOUSE NATIONAL SECURITY COMMITTEE

MORALE, WELFARE AND RECREATION PANEL

ON

**THE EFFECT OF THE FORCE STRUCTURE DRAWDOWN
ON MORALE, WELFARE AND RECREATION PROGRAMS**

MARCH 29, 1995

AIR FORCE SERGEANTS ASSOCIATION

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Mr. Chairman and distinguished members of the panel, on behalf of the 160,000 members of the Air Force Sergeants Association, I thank you for this opportunity to address the value of Morale, Welfare and Recreation (MWR) programs to enlisted personnel and their families. AFSA represents the millions of Air Force enlisted active duty, Air Force Reserve, Air National Guard, veterans and their families.

AFSA believes that the force drawdown, accompanied by an increase in deployments for the remaining Air Force personnel, (four times as many Air Force members are deployed today as were in 1989) has magnified the need for MWR programs. For enlisted personnel, especially those overseas (where almost 21 percent of the force is currently stationed), the air base is a tight, closely-knit society. Base programs and activities become vital to the well-being of all who are stationed in that area. In many cases, personnel are stationed in areas hostile, or at the least inhospitable, to an American presence. The base, besides being a place of security, provides the resources essential to a decent quality of life. These resources include commissaries, base exchange stores and support activities.

The drawdown has intensified financial tension for enlisted personnel. While they have increasingly had to assume responsibilities previously carried by commissioned officers, enlisted compensation has not increased at even the rate of inflation. In order to maintain a decent standard of living, these members and their spouses must often take second jobs. To understand how often this situation occurs, note that 67 percent of today's enlisted force is married, including over 19,000 military couples. There are approximately 654,000 dependents of enlisted service members, including 536,000 who live with these members.

The increased separations and financial pressures lead to problems. For example, during the period of Fiscal Years (FY) 1990-1994, there was a gradual increase of child abuse among Air Force members of one incident per 1000 children, for a rate of 8.8 incidents per 1000 children. During that same period, there was an increase of four incidents per 1000 of spousal-abuse complaints, for a total rate of 13.31 per 1000 spouses. This increase could be the result of greater reporting of abuse, not necessarily an actual increase in incidents. However, because there are more reports of spousal abuse, there is a greater need for support systems to deal with this increase.

Also from FY 1990-94, the suicide rate among Air Force members increased slightly, from .10 to .16 per 1000. The overall rate is small, but increasing.

The Air Force family support system has, as its base-level anchor, Family Support Centers (FSC). There are currently 92 FSCs, staffed by over 900 personnel. The program's purpose is to support retention and unit readiness. It is designed to aid families in coping with the demands of a life in the Air Force, and to help commanders respond to family needs. FSCs provide pro-active, preventative programs and services, designed to minimize

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family disruption and dysfunction. *In FY 1994, there were over three million FSC contacts -- a record high, in spite of the Air Force drawdown!* This clearly indicates that while the Air Force restructures its personnel roles and duties, families are feeling increased stress, and are looking for coping mechanisms.

What all of these numbers and statistics tell us is that there is a need for MWR programs as never before. To that end, we make the following recommendations to support and enhance MWR programs:

1. Continue support for the current commissary and base exchange (BX) system, without any lessening of support. The base exchange (BX) system, run by the Army and Air Force Exchange Service (AAFES), provides vital funding to MWR programs. *One out of every two dollars that fund MWR programs are provided through AAFES.* Three cents out of every dollar spent at BXs go towards this essential funding. The AAFES contribution to MWRs was \$212 million in 1993, the last year for which figures are available. This is at no cost to the taxpayer. The commissary system is also an essential part of the enlisted compensation package. it offsets the lower pay received by enlisted members. In fact, *the one billion dollar commissary subsidy has the same impact for military members as a six percent raise; a six percent raise would cost \$3.5 billion.*

2. Increase support for Child Development Centers (CDC). The Air Force CDC program provides care for 43,000 children daily, in child development centers, family day care homes and youth center programs. However, there are 8,000 children on waiting lists for these programs. 70 percent of them are under three years old. Additionally, every year, 50,000 to 75,000 walk-ins cannot be provided hourly care, and these figures exclude parents who have given up trying to enter the system. Child care is essential because the majority of the 300,000 children 0-12 years of age are from single-parent, dual-military or dual-working families. Additionally, this lack of child care clearly limits the opportunities for families to maintain that crucial second income. The Air Force is looking at ways to improve the ratio of caregivers from 1 in 6 to 1 in 4. We urge the panel to support this initiative.

3. Find ways to improve support for programs which aid physical and mental health. The overall trend in our society is toward healthier lifestyles and improved education. A healthier force is one that can be deployed more quickly and with fewer difficulties. Currently, Air Force fitness centers have enough manpower to operate only 63 to 91 hours a week. This is clearly not adequate to meet the lifestyle requirements of the enlisted force, who work difficult schedules, including long hours and shift work. Their hours are limited even more by child care difficulties. The "hands-on, actual work" nature of enlisted jobs make physical release even more important.

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Libraries play important roles in education, entertainment and in aiding employment opportunities for enlisted personnel affected by the drawdown. With fewer career opportunities now available in the Air Force, increasing numbers of enlisted personnel are studying for a better education, hoping to increase their employment opportunities when they leave the service. The library system plays a vital role in the educational system. We urge the panel to support Air Force initiatives to improve the library system.

Mr. Chairman, we recognize that the Congress is facing tremendous work in its attempts to balance the budget. However, we ask the panel to recognize that enlisted military personnel sacrifice an inordinate amount while serving their country. The current drawdown has affected all service members in one way or another. MWR programs have always played a vital role in providing military members and their families ways to cope with the stress of a life in the military. The inability of many of these programs to keep pace with demand during the drawdown indicates that military personnel consider these programs an essential part of their lives. AFSA urges the panel to continue to fully support these programs.

Sir, we appreciate the opportunity to express the views of AFSA's membership. As always, we are ready to lend support on matters of mutual concern.



Mr. MCHUGH. We will stand in recess subject to a recall of the Panel's next hearing which will be held next week, April 6, at 10 a.m. Again, thank you all.

[Whereupon, at 3:52 p.m., the Panel was recessed.]

[The following questions were submitted for the record:]

Executive Resale Board

Question: Exactly what role does the Executive Resale Board play in developing policy or providing guidance on resale issues? It appears that the composition of the board membership is heavily weighed in favor of the exchange/MWR communities. How does DoD ensure equity and fairness to the commissary system in such a biased environment?

Mr. Pang: The Executive Resale Board is a forum for leaders of the exchange, commissary, and Service MWR programs to discuss resale and MWR business operations and provide recommendations and issues to me. The seven member Board includes the Commander/Director of AAFES, NEXCOM, USMC/MCX, DeCA, and the Army, Air Force, and Navy MWR programs. (USMC/MCX is the combined Marine Corps exchange system and MWR program.) The Board is chaired by a senior member of my staff and representatives of the Military department Secretariats are also invited to attend.

The Board has been effective in developing cooperative agreements and recommending new concepts and procedures. Policy issues identified by the membership are staffed with the Services and within the Department to ensure all exchange, commissary and MWR issues are addressed. In operation, the Board has been helpful to all and has not been biased against any participant.

Logistics Management Institute Study of the Army

Question: A study by the Logistics Management Institute showed that nearly \$230 million could be saved each year by combining certain aspects of the MWR program with the military exchanges. What has DoD done to take advantage of this opportunity to reduce costs that could save patrons and taxpayers so much money?

Mr. Pang: The Department does not advocate consolidation of the exchange services and MWR programs. The purposes of the two programs differ, dictating different management practices. Generally, the MWR programs are decentralized to best meet each installation's mission and operational tempo. The exchanges, on the other hand, achieve efficiencies through more centralized operations. Both are successful in their own right and achieve the proper balance between efficiency and effectiveness. Exchanges and MWRs operate a separate range of revenue generating programs. Nevertheless we believe we can gain efficiency by sharing some common support systems where it makes good business sense to enter into operational partnerships.

MWR Overhead

Question: There is tremendous overhead in MWR programs. And overhead just forces higher prices and increased appropriations. For example, in budget documents received by the committee nearly \$250 million of the appropriation and nearly \$400 million each year in nonappropriated funds go for just management and overhead. In fact, if we reduced overhead by half, as recommended by various studies, we could save each military member \$250 a year. Why is DoD so reluctant to take advantage of these opportunities for savings?

Mr. Pang: The Department closely monitors the Services' MWR programs and the levels of appropriated fund support. In 1990, the Department began an aggressive program of actions to identify and achieve efficiencies, reduce overhead, and increase savings through cooperative initiatives between and among the Services' MWR programs and the exchange services and the Services' MWR programs and the exchange services have also undertaken joint cooperative initiatives to streamline their organizations.. The DoD Executive Resale Board is charged with extending and widening the cooperative initiatives of the MWR and resale programs.

Quality of Life Initiative

Question: Please describe the Quality of Life initiative of DoD and what is the role of MWR in this program? Has there been any increase in funding for MWR programs as a result of this policy?

Mr. Pang: The Quality of Life initiative includes: compensation and benefits, housing, and community and family support. First, \$7.7 billion was allocated to fund military pay raises through the end of the century. This is an unprecedented commitment and provides for the full pay raise rate authorized by law. Second, Secretary Perry committed \$2.7 billion over the next six years to fund quality of life initiatives.

The MWR program is an essential component of the Quality of Life initiative. The Secretary's initiatives added \$71.6 million for MWR in FY 96. This increase includes \$33.5 million for recreational programs which will move all the Services toward a minimum standard of \$295 per capita. Last year our initial review indicated there was a significant disparity between the Services per capita allowances. By establishing this minimum standard, the United States Marine Corps standard was increased, and brought to a comparable level with the other Services.

Project Validation

Question: The Panel has consistently urged the DoD to employ outside consultants to validate the construction requirements for the armed services MWR programs. Are these validations binding or can the services deviate from the consultants recommendations? Do we need a broader validation of requirements either at the DoD level or at the installation level where PXs and all other community service availability are considered in determining whether a project is needed?

Mr. Pang: Validation is just one step in the process for determining which major construction programs the Department supports each year. Each Service weighs a variety of factors to include quality of life projects, return on investment, projected sales, and associated factors. Projects are then approved by the Service or Exchange Board of Directors and subjected to a detailed review by my staff.

The Department encourages both the exchange services and Services MWRs to have their major NAF construction projects (\$500,000 or more) validated by outside consultants. The Army and Air Force MWR major construction projects are validated by outside consultants and deviations from the consultant reports are permitted when they make good business sense or are required to comply with other constraints. Their validation processes consider the availability of services on and off base. The Navy and Marine Corps validation guidelines and requirements are determined by their respective Boards of Directors. However, in the future, the Navy will utilize an independent consultant to validate all projects over \$1.5 million.

Major NAF construction projects originating in the exchange services are validated using criteria developed and approved by each exchange services Board of Directors.

Child Care

Question: We have heard that nearly 60 percent of the total MWR appropriation is now being consumed by military child care and that this represents a large subsidy to a small percentage of DoD people. This is in addition to a hefty subsidy from nonappropriated funds for this purpose. What efforts are being taken in DoD to ensure that there is a proper balance between the needs of those people that have children and the requirements of the rest of the people on military bases?

Mr. Pang: Child care represents approximately 25 percent of the total \$1.0B MWR appropriation. We believe that there is a reasonable balance, particularly in light of the fact that NAF subsidies for child care have all but been eliminated. In 1992, the subsidy was \$37.5 million. The total NAF subsidy as of March 1995 was \$1.5M, or less than one-half of one percent of the total child care program. The Services have worked diligently to reduce the previous NAF subsidies and through improved management we hope to eliminate NAF subsidies except in individual cases when commanders need the discretion to manage their NAF to accomplish specific missions.

There is a great demand for child care in DoD. On a daily basis the child development programs serve 200,000 families. Currently, we are meeting 52% of the total DoD child care need. Secretary Perry's Quality of Life (QoL) initiative added \$38M to child care in FY 96, which will allow us to meet 65% of the need.

BRAC Funding

Question: What has been the experience in gaining base closure and realignment funding for MWR projects?

Mr. Pang: Department policy is that nonappropriated fund activities may compete for available BRAC funding. The Services have successfully competed for the following BRAC dollars:

- The exchange services have received \$20 million (6 projects)
- MWR programs have received \$38.6 million (9 projects)

In the MWR area, BRAC funding has been used for Child Development and Fitness Center construction while the exchange services used this funding for main store construction and expansion of existing exchange facilities on installations affected by BRAC decisions.

Residual Value Funding

Question: The U. S. was suppose to realize a substantial gain from the sale of facilities at closed overseas bases. Have any of these proceeds been realized and, if not, why not?

Mr. Pang: The Department has not received any residual value funds for NAF facilities on closed overseas installations. Negotiations are continuing; however, current indications are that payment in kind (PIK) compensation may produce some results.

Investment Oversight

Question: What are the results of the most recent DoD investment oversight review? Given the decentralized nature of the DoD MWR system, how can DoD ensure that installations are not using excess cash on new facilities that will not provide a good return on investments?

Mr. Pang: The Department's policy for NAF investments is fundamentally sound. It is based on the principles of safety, liquidity, and yield. Nonappropriated funds are accumulated only to finance identified liabilities, contingencies, and planned capital expenditures. Accumulated funds are safely invested so that funds are available when needed and interest is earned to preserve the value of the funds. The Department is issuing policy clarification to emphasize program management oversight, to include:

- Fiduciary responsibility for nonappropriated fund investments is assigned to the managing Component or Military Service headquarters.
- The Component oversight shall provide for regular reviews and technical advisors who are independent of the control and management of the portfolio.

- Significant losses and circumstances where investments are not earning interest shall immediately be reported to the Component or Military Service headquarters.

Regarding the Department's oversight responsibilities, we are drafting a charter for the DoD Investment Oversight Committee and seeking expert advisors to assist in the annual review.

Funds obligated by individual installations could prove to be not affordable or may not be good investments. It should be noted that it would be impossible to ensure that such a situation never occurs. The Department must rely on prudent management implementation of established policies and procedures. Within the Services, installations can approve construction projects costing less than \$200,000. These projects, are reported by the installation in their annual budget submissions, thereby allowing for a program-wide assessment by the exchange services and Services' MWR programs. Projects costing \$200,000 and above receive a more detailed review, and projects costing more than \$500,000 are reviewed and approved by OSD and reported to Congress.

Appropriations Among the Armed Services

Question: The panel is concerned that there continues to be a disparity among the armed services over the treatment of their people. It appears that, despite congressional increases in appropriations, the Navy continues to come up short on its funding. And, that this policy has the practical effect of having the Navy keep cigarettes out of its commissaries so that sailors can only buy them in exchanges. To make matters worse, sailors also have to pay a higher mark-up in exchanges for these products than their counterparts in the Army and Air Force. Military people make the same amount of money regardless of the branch of the armed service to which they are assigned. Therefore, don't we need a consistent policy throughout for pricing items? How do you reconcile this pricing disparity and what do you intend to do to address it?

Mr. Pang: Commissaries on Army, Air Force, and six Navy installations sell cigarettes; on Marine Corps installations and the remaining Navy installations cigarettes are sold only in exchanges. This balance is the result of the agreement made when DeCA was established which reflected the Department of the Navy's concern that cigarette sales in commissaries would affect the MWR contribution from the exchanges.

The exchange services react to local market conditions to remain competitive. They conduct market surveys to determine how they price merchandise. Recent comparison surveys have shown Navy Exchange prices are very comparable to AAFES. An exception to price comparability is cigarette pricing where Navy has implemented a smoking cessation policy. Navy Exchange pricing of cigarettes recognizes this policy while still providing the opportunity for patrons to purchase cigarettes at a reduced cost.

Long-Range Planning

Question: Would you please elaborate on the DoD efforts to institute long-range planning into the MWR program?

Mr. Pang: The Department has taken aggressive action to ensure its policies are responsive to the needs of our Service members and the programs and businesses that help to support important aspects of their quality of life. The Department has made great strides toward gaining increased oversight and cooperation between the Military Department's MWR and exchange services programs. Like other government entities, the Department's MWR programs and exchange services are focusing on cost reductions, and streamlining and improving operation, while providing quality service to all customers.

To meet current and future demands, the Department has taken several actions, to include:

- Reestablishing the DoD Executive Resale Board.
- Analyzing the management practices and policies of the MWR program to determine business process improvements.
- Reviewing, reorganizing and updating Department Directives and Instructions for MWR and exchange service programs.
- Investigating cooperative efforts between MWR, exchange services and commissary programs.
- Reorganizing and reviewing the nonappropriated fund and commissary surcharge construction program.
- Designing and implementing a resource management long-range financial plan for each MWR, exchange service and commissary program.
- Including MWR programs in the scope of the assessment of the DoD Quality of Life Task Force.

Health Plans

Question: Last year, the Congress required a single, uniform health plan for nonappropriated fund employees with an implementation date of October 1, 1995. What has been the progress on this program?

Mr. Pang: The FY 95 Authorization Act required the Secretary, not later than October 1, 1995, to "take such steps as may be necessary to provide a uniform health benefit program" for NAF employees. Last fall, the Department allocated funds and began the lengthy procurement process to obtain an employee benefits consulting firm to analyze the current six NAF employee health care plans and recommend a uniform program as a replacement. We are currently evaluating proposals from firms with expertise in health benefits. Award of contract will be made as soon as all required procurement procedures are completed. The contractor selected is expected to require several months to analyze and prepare recommendations.

DoD provided a status report to the HNSC and SASC in February. We will again report on the progress of the project in October.

Investment Funds

Question: DoD Instruction 7000.12 prohibits the accumulation of excess nonappropriated funds for the purpose of investment only. What action do the services and OSD take to ensure that the amount of funds held are not excessive?

Mr. Pang: It is DoD policy that nonappropriated funds are not to be kept for the sole purpose of earning higher interest income. Further, the FY 95 National Defense Authorization Act mandated that funds may not be retained in a nonappropriated MWR account of a military installation in excess of the amount necessary to meet the cash requirements of an installation. Amounts in excess must be transferred to a single Service-wide account.

The Department's policy requires that NAFIs operate under the "going concern" concept and that NAF investments are to be accumulated only to finance planned uses. At least annually the Department convenes the Investment Oversight Committee to review investments. FY 94 annual reports indicate that investment balances of the MWR organizations are committed. Planned uses include working capital (liabilities, inventories, etc.), employee benefits, loans, self-

insurance loss reserves, new operational programs, mobilization contingencies, construction programs, capital equipment, and tangible fixed assets.

Consolidation of PXs and MWR Programs

Question: At the request of the Army, the Logistics Management Institute assessed the advantages of management options for PXs and MWR. One option said that merging MWR and exchanges could save from \$85 million to \$97.9 million per year ... just in overhead cost reductions alone. Why has DoD and the Army been so reluctant in taking advantage of these reductions so that savings could be passed on to the troops?

Mr. Pang: I agree that cost reductions can be accomplished through cooperative ventures to gain the efficiencies of both systems. For example, the Army and Air Force Exchange Service and the Army Community and Family Support Center are "partnering" their efforts to include needs assessment in the areas of food, beverage, and entertainment, amusement machines, business television training, construction processes, printing services, and leisure travel ticketing.

While I do not believe that consolidation of the exchange services and MWR programs would be in the best interests of service members and their families, I support operational partnerships that make good business sense.

Categorization of MWR Programs

Question: There are strict restraints on the use of appropriations for certain MWR programs. However, to date, the Congress has chosen not to institute similar restrictions on the use of nonappropriated funds for those programs that are to be funded with appropriations. Are tighter rules needed in this regard?

Mr. Pang: In 1987, the Department, in partnership with the Congress, reassessed MWR program authorizations, organization, staffing, and funding policies. The Department separated MWR programs into three categories: A, B, and C. The extent to which a program may use appropriated funds, nonappropriated funds, or a mix of both is directly related to its category. Category A programs most directly support readiness and are intended to be supported principally by appropriated funds.

While appropriated funds provide a basic level of support, service members often require activities, equipment or hours of operation that exceed these basic levels. Supplementing activities with nonappropriated funds offers commanders the ability to meet these requirements. Restricting the use of nonappropriated funds will degrade the availability and quality of these readiness support programs and the Department does not feel that tighter rules for the use of nonappropriated funds are needed.

Credit Card Programs

Question: We have learned that there are a number of credit card programs for military personnel. For example, the PX systems offer credit and the commissaries are testing acceptance of credit cards. We have also learned that the MWR programs are offering credit cards and that a separate Army card is being tested. And, a new Air Force Card has been authorized for MWR programs. This is all in addition to commercially available credit cards like VISA and American Express. What efforts are being made to ensure that the credit card programs of the MWR and resale entities are not getting out of control?

Mr. Pang: The Department shares your concerns and has taken action to address these issues. A study of the exchange credit systems by Price Waterhouse was provided to Congress on March 17, 1995. The study found that the exchange service credit programs were financially solvent and were providing a needed and welcome lower cost credit service for service members and their families. The Department now requires all exchange and MWR programs to do credit

checks on new accounts; the exchanges to obtain Standard and Poors ratings quarterly; and year-end certified financial audits to be made. These audits will address the financial status as a whole and credit programs in particular. A follow-on study by Systems Research Applications, Inc. (SRA) is being conducted to determine the feasibility of consolidating the credit programs.

Per Capita Appropriations

Question: The Secretary of Defense Annual report to the President and the Congress stated the following with regard for appropriations: "A baseline of \$295 per capita will be instituted."

Mr. Secretary, have we taken the least common denominator as an objective, and how do you propose to cross level resources among the armed services to ensure that military members are not treated unequally because of the branch of service?

Mr. Pang: The Department's policy for appropriated funding is designed to assure service members and their families that there is equity in the MWR programs furnished by the government and for those programs which are paid through nonappropriated funds.

The baseline mentioned in the Secretary's Annual Report represents an important initiative in this regard. The "floor" of \$295 per capita has been funded through 2001 as part of Secretary Perry's Quality of Life initiative. The level is derived from the expenses necessary for the direct delivery of the most essential MWR activities. Typically, this is the cost of equipping, supplying, and staffing activities such as libraries, fitness centers, sports and recreation programs, and community centers. The per capita measure does not include indirect support such as military personnel, maintenance and repair and utilities, nor does it include child care or youth programs. We are also working with the Services on standard metrics that can improve our ability to make performance comparisons across the Services.

Construction

Question: It appears that there are certain functions that lend themselves to cooperation where the taxpayer could benefit without reducing the benefits provided to military people. One example appears to be cooperation in the use of facilities and personnel between DoD schools in the United States and overseas and the various youth programs in the DoD. Several years ago, the panel suggested that it would be advisable under certain conditions to take advantage of this opportunity. What progress has been made on this panel recommendation?

Mr. Pang: The DoD Dependent Schools facilities may be used during other than normal school hours with the approval of the school principal. Organizations are usually limited to those of an MWR or educational nature. Community organizations (overseas and CONUS) using school facilities on a recurring basis use a cost sharing formula for utilities, custodial services, maintenance and repair services and other basic support services.

Investments

Question: It has long been the panel's position that cash should not be held for investment sake and that the earnings from the programs should be used to build new facilities and provide better programs. Toward this end, we have mandated centralized management of cash to accelerate the movement of profits to the intended recipients. How is this process going? What are its benefits and its drawbacks?

Mr. Pang: As you indicated, the National Defense Authorization Act for FY 1995 limits the amount of nonappropriated funds that may be retained in the MWR account of a military installation to the extent necessary to meet the cash requirements of that installation. Based on the new law, we require the transfer of excess installation level nonappropriated funds to a Service headquarters level nonappropriated fund instrumentality.

The centralized management of cash permits excess cash to be used for capitalization requirements and not just drawing interest.

It has been DoD policy to examine cash balances against planned commitments. For several years, the Services have worked towards reducing cash balances most notably through their facility construction and improvement programs. As a result of centralizing the management of cash, service members and their families have benefited from additional quality of life facilities and programs.

Public/Private Ventures

Question: What has been the experience with regard to public and private ventures?

Mr. Pang: Department policy encourages consideration of commercial alternatives on a case by case basis to deliver the most cost effective resale and MWR programs, joint Service MWR programs, and reciprocal agreements with local communities.

The exchange services use public and private ventures (PPV) in several ways. Using PPV construction methods enables facilities to be built faster and cheaper than conventional military construction methods. AAFES uses PPVs for theater construction, while NEXCOM uses PPVs for food operations (McDonalds) and auto service centers. Future AAFES plans call for a PPV partnership with Firestone for auto service stores.

Army MWR used PPVs for Guest Houses (transient lodging facilities for permanent change of station families) at three locations: Fort Bliss, Fort Drum and Hawaii. The Hawaii Guest House success is due to the larger travel lodging benefits paid to Service members. The CONUS PPV Guest Houses ended in buyouts of the contractor by the Army, and based on this experience, the Army does not plan to use PPV for future CONUS Guest Houses. In addition, the Air Force has also recently contracted with the National Headquarters of the Boys and Girls Clubs for Field Support to Youth Centers.

On-Base Competition

Question: What efforts are made to ensure that there is not undue competition among MWR programs and PXs on military bases?

Mr. Pang: While competition is normally healthy, it does not always benefit service members in the long run when there is direct competition between the exchange services and MWR activities on installations. The Department is in the process of releasing new Department of Defense guidance on exchange and MWR programs to ensure that the roles of each organization are clearly delineated.

FUNDING REQUEST

Mr. McHugh: Would each of you describe the fiscal year 1996 budget request for MWR? In which areas are there program increases and decreases, and does this represent any change in priority?

General Meyer: The Army's fiscal year 1996 budget request for MWR supports the Department's efforts to continue improving the quality of life of Service members. With the help of recent initiatives by the Secretary of Defense, this budget request enables commanders to sustain quality programs and services at rates affordable by soldiers and families.

Priorities have not changed. Rather, the Army has reemphasized those programs that most directly influence the community support of soldiers through the MWR Strategic Plan and establishment of fiscal standards. This budget serves as the foundation. Demand-driven, mission sustaining MWR programs and basic community support services have been given the highest priority. The delivery systems for these programs and services are designed to be the most effective in terms of cost efficiency and quality of services, while reducing NAF support to APF missions.

MWR OVERHEAD

Mr. McHugh: There is tremendous overhead in MWR programs. And overhead just forces higher prices and increased appropriations. For example, in budget documents received by the committee nearly \$250 million of the appropriation and nearly \$400 million each year in nonappropriated funds go for just management and overhead. In fact, if we reduced overhead by half, as recommended by various studies, we could save each military member \$250 a year. Why is DOD so reluctant to take advantage of these opportunities for savings?

General Meyer: I do not believe that DOD or the Army is reluctant to take advantage of opportunities for savings in overhead. Within both DOD and the Army, we are actively pursuing several possibilities for savings and efficiencies in overhead. The Army and the Air Force jointly are already accomplishing or are looking at options where we can form partnerships to improve services while reducing costs. Examples of this include negotiating contracts which may be used by both services, specifying standard commodity items for bulk purchase, and investigating the feasibility of AAFES personnel and payroll systems meeting Army and Air Force NAF requirements.

The Army is also looking at ways to further consolidate overhead functions. We have been working with DFAS to finalize the consolidation of NAF accounting in CONUS. USAREUR has made significant progress in reducing overhead through implementation of a single MWR fund for all of USAREUR. We have just finalized and are installing an automated NAF budget system at each installation which will not only improve the budget process but significantly reduce the associated workload as well. An automated time labor management system is also part of the installation management information system being finalized and installed. Implementation of the NAF credit card has simplified procurement of smaller dollar items at Army installations. We are also looking at the possibility of fleet management for the myriad of NAF vehicles used in MWR programs.

Implementation of aggressive profitability goals for fiscal year 1996 and beyond will also cause Army installations to closely scrutinize overhead functions and costs to ensure maximum value added. We will continue to look for innovative ways to support programs that concentrate resources within the programs instead of in overhead.

EXCHANGE DIVIDENDS

Mr. McHugh: We have learned that dividends from the exchange services have been reduced due to force structure reductions and reduced sales. Would each of you please describe the extent of these decreases on your programs and what has been the impact? How do you intend to make up for these shortfalls?

General Meyer: Exchange dividends are a major source of funding for the Army's Nonappropriated Fund major construction and program investment. Examples of program investment include training, marketing research and management information systems. These programs are financed on a cash flow basis, matching future streams of dividends with requirements as they are forecasted to become payable.

For fiscal year 1995, dividends are anticipated to decline fifteen percent from original plans. This is primarily due to force restructuring. It will require greater borrowing by the Army's Central Fund from the Army Banking and Investment Fund to help support projects already under construction. If the downward trend continues into 1996-2000 at the 1995 rate, future major construction programs may be reduced by as much as 40 percent. This could have serious impacts on the Army's ability to modernize and maintain the MWR physical plant.

ARMED FORCES RECREATION CENTER - EUROPE

Mr. McHugh: Please describe circumstances that led to the recent decision not to renovate the hotel at Berchtesgaden, Germany.

General Meyer: In response to a request from the German government, the Army had agreed to close our Armed Forces Recreation Center operations in Chiemsee and return that property to German government control in exchange for their funding repairs to the hotels in Berchtesgaden. The Army previously renovated the hotel in Chiemsee at a nonappropriated fund cost of \$13 million. The hotel subsequently closed in early 1994. In January 1995, the German government withdrew their offer to fund renovations in Berchtesgaden. Based on that decision, the Army will terminate operations of hotels in Berchtesgaden in September 1995 and return those facilities to the German government. The campgrounds at Chiemsee reopened in June 1995; hotel operations in Chiemsee will resume by November 1995. The endstate of AFRC-Europe will be two hotels in Garmisch and two hotels in Chiemsee.

THAYER HOTEL AT WEST POINT

Mr. McHugh: Would you please describe to the panel the situation with regard to the upgrading of the Thayer Hotel at West Point.

General Meyer: The Thayer Hotel opened in 1926. Congress authorized a private developer to build and operate the hotel in order to service the general public as well as friends and relatives of cadets. In 1943, Congress authorized purchase of the hotel from the owner and transferred operational responsibility to the Superintendent of the United States Military Academy to be operated as a nonappropriated fund hotel. It is the only Department of Defense nonappropriated fund operation open to the general public at the direction of Congress. The hotel is in need of major repairs and renovations in order to meet current health, fire and safety standards as well as modern guest service expectations. Although it has been modestly profitable for many years, funds have not been available to make the needed improvements. For several years the Army has pursued a privatization plan whereby a developer will renovate, expand and operate the hotel with no direct capital investment of Army nonappropriated funds. Total project cost will be \$55 million of which \$6 million is developer equity, a \$1 million nonappropriated fund contribution from the United States Military Academy, and \$48 million from a commercial bond issuance. As the hotel is located on a government installation, commercial financing can only be attained if the Army underwrites the developer's debt service. In concert with Congressional guidance the Army has selected a developer and is crafting an arrangement which will limit the Army's nonappropriated fund cost or risk to no more than \$25 million. The Army liability will terminate when the bonds are re-tendered at the end of the tenth year of operations. Negotiations are ongoing and we project that a decision of whether or not to proceed will be made by the end of August 1995.

CATEGORIZATION OF MWR PROGRAMS

Mr. McHugh: There are strict restraints on the use of appropriations for certain MWR programs. However, to date, the Congress has chosen not to institute similar restrictions on the use of nonappropriated funds for those programs that are to be funded with appropriations. Are tighter rules needed in this regard?

General Meyer: No. Army MWR has established fiscal standards which implement Congress' intent and the Department's policy. Nonappropriated funds supplement appropriations in those instances where service members' demands for activities, equipment, or hours of operation exceed the government's obligation to provide support. In today's fiscal climate, restricting the use of nonappropriated funds will surely force commanders to degrade the quality and availability of the programs most directly affecting the readiness of the active duty force.

Executive Resale Board

Question: Exactly what role does the Executive Resale Board play in developing policy or providing guidance on resale issues? It appears that the composition of the board membership is heavily weighed in favor of the exchange/MWR communities. How does DoD ensure equity and fairness to the commissary system in such a biased environment?

Answer: The Board is not a deliberative body, or a policy making group. It serves as a forum for sharing information and promoting cooperative efforts in areas of mutual interest and ensuring that all points of view are expressed. The Commander or Director of each member organization represents its interests and there are no issues requiring votes. Equal representation has not been an issue in the past.

Funding Request

Question: Would each of you describe the fiscal year 1996 budget request for MWR? In which areas are there program increases and decreases, and does this represent any change in priority?

Answer: Projections for FY 96 appropriated funding represent the amount needed to sustain current programming levels. The FY 96 projections are consistent with FY 94 execution and FY 95 programming for all activities except child development and youth activities. Child development and youth program funding will increase by \$19.3 million.

Logistics Management Institute Study of the Army

Question: A study by the Logistics Management Institute showed that nearly \$230 million could be saved each year by combining certain aspects of the MWR program with the Military Exchanges. What has DoD done to take advantage of this opportunity to reduce costs that could save patrons and taxpayers so much money?

Answer: The AF was not a party to this study. However, the DoD Executive Resale Board identified a wide range of potential initiatives for partnering that fall into five areas: business opportunities and improving services; human resources; acquisition, buying and merchandising; support systems; and legislative adjustments. The DoD resale community is actively exploring these opportunities to save money and improve service to all. Notable items for consideration include expanding the AF Essential Products Program for purchasing common goods, coordinating approaches on construction processes, streamlining workers' compensation claims processing, and joint patron assessment surveys.

MWR Overhead

Question: There is tremendous overhead in MWR programs. And overhead just forces higher prices and increased appropriations. For example, in budget documents received by the committee nearly \$250 million of the appropriation and nearly \$400 million each year in nonappropriated funds go for just management and overhead. In fact, if we reduced overhead by half, as recommended by various studies, we could save each military member \$250 a year. Why is DoD so reluctant to take advantage of these opportunities for savings?

Answer: The AF is taking steps to reduce overhead costs where prudent. However, some of these costs are solely for Congressionally mandated oversight and compliance. As a result of recent AF MWR

Advisory Board attention in this area, the AF has reduced overhead expenses substantially by modernizing our computer systems and improving business processes. In addition, the AF Club Membership Card initiative will cut accounting overhead 20% after full implementation. Increased emphasis on centralized purchasing and partnering are driving down overhead (and other) costs even further. Finally, the AF is actively working benchmarking efforts with industry and professional associations, such as the American Institute of Certified Public Accountants, to reduce accounting and other overhead costs.

Exchange Dividends

Question: We have learned that dividends from the exchange services have been reduced due to force structure reductions and reduced sales. Would each of you please describe the extent of these decreases on your programs and what has been the impact? How do you intend to make up for these shortfalls?

Answer: We expect exchange dividends to the AF will be down 25 percent or \$20 million from FY 94 levels. Some of the impact is offset by reductions in the number of facilities and people we need to serve. However, there will likely be a significant impact on our ability to replace capital equipment, build new facilities, and sustain programs at current levels. We will attempt to make up these shortfalls by improving efficiency and productivity through aggressive use of technology, partnering, and improved business practices.

Quality of Life Initiative

Question: Please describe the Quality of Life Initiative of DoD and what is the role of MWR in this program? Has there been any increase in funding for MWR programs as a result of this policy?

Answer: MWR is a vital part of the Quality of Life (QoL) initiative. AF child development and youth programs will receive between \$19-20M per year for FY96-01 from the QoL initiative to help the AF reach the goal of meeting 65% of the need for child care. We have also identified an additional \$158.4M in increased fitness, child care, and library support as candidates for DoD funding.

PROJECT VALIDATION

Question: The Panel has consistently urged the DOD to employ outside consultants to validate the construction requirements for the armed services MWR programs. Are these validations binding or can the services deviate from the consultant's recommendations?

Answer: Air Force relies heavily on outside consultants to validate facility projects. Deviations from the consultant reports are permitted when they make good business sense or are required to comply with other constraints.

Question: Do we need a broader validation of requirements either at the DOD level or at the installation level where PXs and all other community service availability are considered in determining whether a project is needed?

Answer: We already require our independent consultants to consider the availability of similar services offered by other providers both on- and off-base.

Child Care

Question: We have heard that nearly 60 percent of the total MWR appropriation is now being consumed by military child care and that this represents a large subsidy to a small percentage of DoD people. This is in addition to a hefty subsidy from nonappropriated funds for this purpose. What efforts are being taken in DoD to ensure that there is a proper balance between the needs of those people that have children and the requirements of the rest of the people on military bases?

Answer: Child care represented 16.7% of the FY 94 AF MWR appropriated fund operating budget without MILCON and 23% including MILCON. Air Force child care serves over 10% of the AF population at any one time and almost all families during the career of the military member. Over 82 percent of the members served are enlisted families. Through diligent cost cutting measures, the AF has been extremely successful in virtually eliminating the NAF subsidy to Child Care. DoD's Quality of Life initiative is working to balance child and youth programming with the other high-priority needs such as fitness and libraries.

BRAC Funding

Question: What has been the experience in gaining base closure and realignment funding for MWR projects?

Answer: The AF has had some success in receiving BRAC impact money for Child Development Center and Fitness Center construction. However, we have not received any BRAC impact money for other MWR projects.

Residual Value Funding

Question: The U.S. was supposed to realize a substantial gain from the sale of facilities at closed overseas bases. Have any of these proceeds been realized and, if not, why not?

Answer: The Department of Defense has received some residual value for AF facilities returned to host nations in Europe, specifically Belgium and Italy. However, to-date there has been no specific payback for individual AF MWR facilities returned at overseas bases. The German government, in concert with commercial aviation officials, recently agreed to contribute 100 million Deutsche Marks towards construction projects at Ramstein AB as payment-in-kind in exchange for some facilities taken over at Rhein-Main AB. Some of the remodeled facilities may be used to support MWR programs.

Procedures, circumstances, and international agreements vary by country and affect requests for compensation for returned facilities. They impact recovery of residual value. For example, there is no remuneration in Spain. In Japan, nearly all construction projects are built with government of Japan funds, so most facilities at closed bases are simply returned to the Japanese government.

Investment Oversight

Question: What were the results of the most recent DoD investment oversight review? Given the decentralized nature of the DoD MWR system, how can DoD ensure that installations are not using excess cash on new facilities that will not provide a good return on investment?

Answer: The last DoD oversight review gave high marks to the Air Force NAF investment program. Our program is based on the guiding principles of safety, liquidity, and yield with the primary emphasis on safety. Before approving new facility construction or major renovations, we evaluate each project through our independent needs assessment process and validate projects on basis of need and return on investment. We only build those projects that make good sense based on AF-wide priority of need.

Construction

Question: It appears that there are certain functions that lend themselves to cooperation where the taxpayer could benefit without reducing the benefits provided to military people. One example appears to be cooperation in the use of facilities and personnel between DoD schools in the United States and overseas and various youth programs in DoD. Several years ago, the panel suggested that it would be advisable under certain conditions to take advantage of this opportunity. What progress has been made on this panel's recommendation?

Answer: The AF is collaborating with DoD schools to operating a number of preschool, before and after school, and summer youth programs in DoD classrooms and gymnasiums.

Investments

Question: It has long been the panel's position that cash should not be held for investment sake and that the earnings from the programs should be used to build new facilities and provide better programs. Toward this end, we have mandated centralized management of cash to accelerate the movement of profits to the intended recipients. How is this process going? What are its benefits and its drawbacks?

Answer: The Air Force swept excess funds from field accounts in 1992 and used them to accelerate funding for needed capital improvements. The AF also modified its dividend distribution policy and began reviewing cash at installations on a quarterly basis to make sure it did not grow beyond their immediate needs. To-date, we've been successful in preventing the accumulation of excess cash at installations. In addition, the consolidation of cash allowed the AF to finance an aggressive NAF construction program in past two years, approving nearly \$200 million in facility improvements for customers.

Benefits: Accelerates the flow of cash into capital improvements and supports common cause by making funds available to meet AF construction requirements based on priority-of-need rather than an individual installation's ability to generate funds.

Drawbacks: Adds to "central overhead" to manage the program and takes away from field "ownership" of the program.

Public/Private Ventures

Question: What has been the experience with regard to public and private ventures?

Answer: The Air Force has contracted out the provision of youth counselors for youth centers during FY 95 and is contracting with the National Headquarters of the Boys and Girls Club for field support to youth centers. We have also contracted out the training of child care staff on inclusion of special needs children and the training of youth staff on serving at-risk youth.

On-Base Competition

Question: What efforts are made to ensure that there is not undue competition among MWR programs and PXs on military bases?

Answer: AF policy gives exchanges primacy for certain resale activities. Our AF simplified dividend policy distributes dividends to each installation based on exchange sales at that base. That gives bases a "stake" in local exchange operations and improved communications between MWR and exchange personnel. In addition, our needs assessment process for MWR facility projects considers availability of similar or related exchange services (as well as off-base sources), to reduce duplication. Our partnering initiatives have helped cement relationships at HQ level and provide a vehicle for minimizing unnecessary overlap. We promote joint resolution of conflicts at lowest level and are not aware of significant problems in this area.

EXECUTIVE RESALE BOARD

Chairman: Exactly what role does the Executive Resale Board play in developing policy or providing guidance on resale issues? It appears that the composition of the board membership is heavily weighted in favor of the exchange/Morale, Welfare and Recreation (MWR) communities. How does DoD ensure equity and fairness to the commissary system in such a biased environment.

Admiral Marsh: The Executive Resale Board is an advisory and coordination group that identifies and supports commissary, exchange and MWR cooperative initiatives. The Executive Resale Board has proven to be an excellent advisory forum to coordinate issues which impact all programs (e.g, single Department of Defense (DoD) Health benefits programs, commercial sponsorship opportunities, etc.). The Board also provides an opportunity to share good ideas and serves as a conduit for cooperation on common interest items.

The Executive Resale Board is made up of representatives from the various program elements including commissaries. This Board was designed as a communications tool and not a decision-making body. It does not force actions on any of its members. Thus, the issue of protecting commissary interests from MWR or exchange bias or weighing out any voting process to protect commissary has never been desirable or necessary.

The inclusion of MWR, exchanges, and the Defense Commissary Agency (DeCA) in this forum facilitates the identification and pursuit of common issues, improves the synergy between exchange profit distributors and those who put the profits to use for military members in MWR programs. In the current downsizing environment, it has also offered an opportunity to pursue common objectives in adjusting to a smaller military community supported.

The OSD chaired strategy session of the Resale Board held at Virginia Beach in March 1995 is an excellent example of the effectiveness of the Executive Resale Board in bringing Program Managers for exchanges, DeCA and MWR together to take advantage of common support opportunities. The meeting focused on interservice support arrangements and common issues.

The forum helped to bring exchange and commissary program leadership together to consider opportunities such as combined DeCA and exchange operations (NEXMARTs), strategy for support on Base Realignment and Closure (BRAC) bases, and joint construction initiatives to reduce costs and improve customer convenience such as at Port Hueneme.

FUNDING REQUEST

Chairman: Would each of you describe the fiscal year 1996 budget request for Morale, Welfare and Recreation (MWR)? In which areas are there program increases and decreases, and does this represent any change in priority?

Admiral Marsh: The Operations and Maintenance (O&M,N and O&M,NR less NEX) funding levels presented in the FY-96 President's Budget which represent post-BRAC infrastructure and end-strength are:

	FY94	FY95	FY96	FY97
Category A	137,808	138,341	139,134	139,699
B	101,243	118,815	111,727	115,741
C	24,554	19,889	19,646	20,551
Total	263,605	277,045	270,507	275,991

The decrease in funds from FY95 to FY96 represents the effect of BRAC closures. No major changes in priority in FY96.

LOGISTICS MANAGEMENT INSTITUTE STUDY OF THE ARMY

Chairman: A study by the Logistics Management Institute showed that nearly \$230 million could be saved each year by combining certain aspects of the MWR program with the military exchanges. What has Department of Defense (DoD) done to take advantage of this opportunity to reduce costs that could save patrons and taxpayers so much money?

Admiral Marsh: Navy MWR carefully considered the recommendations of the Logistics Management Institute (LMI) study results which focused on disparities between overhead costs for Army MWR versus AAFES and suggested that merger of Army MWR business activities under AAFES would save a lot of money.

Navy MWR and the Navy Exchange System have entered into cooperative agreements, wherever it has made good business sense, to achieve savings by sharing nonappropriated fund common support functions like facility maintenance, procurement, cashier, personnel, graphics and payroll support functions.

To reduce costs and save patrons and taxpayers money, it is Navy policy that revenue generators must operate on a break even or profitable basis. MWR has improved financial standards, controls and the budgetary system to identify and effect operating corrections in the field and will continue to use joint common support overhead initiatives with the Navy Exchange to produce cost savings for both systems.

MWR OVERHEAD

Chairman: There is tremendous overhead in Morale, Welfare and Recreation (MWR) programs. And overhead just forces higher prices and increased appropriations. For example, in budget documents received by the committee nearly \$250 million of the appropriation and nearly \$400 million each year in nonappropriated funds go for just management and overhead. In fact, if we reduced overhead by half, as recommended by various studies, we could save each military member \$250 a year. Why is the Department of Defense (DoD) so reluctant to take advantage of these opportunities for savings?

Admiral Marsh: Navy MWR shares the committee's concerns about ensuring that overhead costs are minimized and continues efforts to reduce those costs. MWR field NAF overhead fell by 13.7% in FY-94. MWR Headquarters overhead has fallen 22.9% between 1991 and 1994 and will decrease another 30% over the next three years.

Navy MWR is committed to aggressively reducing overhead costs even further. Achieving additional overhead reduction is the top priority of our management assistance teams which have identified savings of over \$6.0 million in overhead costs during on-site reviews of 25 installations since the beginning of FY-95. We continue to emphasize joint common support overhead initiatives with the Navy Exchange to produce cost savings for both systems.

Navy MWR is also revising its accounting system to improve the allocation of costs such as our centrally managed benefits program with the objective of more accurately allocating them to individual activity managers who can control such costs by optimizing the mix of their full time and part time/intermittent work forces. MWR allocates all its headquarters costs to field activities (commenced in FY-94), thereby providing full disclosure and inviting the scrutiny of those who pay the bill. Furthermore, the central fund budget is presented annually to the Vice Chief of Naval Operations, via the MWR/Navy Exchange Board of Directors, for review and approval.

EXCHANGE DIVIDENDS

Chairman: We have learned that dividends from exchange services have been reduced due to force structure reductions and reduced sales. Would each of you please describe the extent of these decreases on your programs and what has been the impact? How do you intend to make up for these shortfalls?

Admiral Marsh: Navy Exchange (NEX) dividends to Morale, Welfare and Recreation (MWR) have declined from \$83 million in FY-88 to \$56 million projected for FY-95. NEX dividends represent an important source of supplemental support for MWR operations (13% of total MWR NAF revenue). These dividends also contribute significantly to funding MWR central and field capitalization needs.

Reduction in these dividends has reduced MWR program funding (and thus flexibility) in the field. This has caused commands that were more heavily dependent on NEX dividends to focus first on cutting overhead costs and also on closing marginal MWR operations (e.g., underutilized clubs) and other Category B and C activities used by special interest groups, such as craft shops. In addition, at some commands, program hours have been reduced and activities consolidated to fewer facilities to reduce infrastructure costs. Reduction in NEX dividends has also been a factor in reduced funding available for capitalization. Adjustments have been made in central and local construction and renovation plans to help counterbalance the reduction.

We have been able to offset much of the shortfall for several reasons. The FY-94 increase in appropriated funds for MWR offset part of the decrease in NEX dividends and allowed MWR to maintain solvency. This allowed some funds to remain dedicated to rebuilding the MWR program infrastructure, and for the field to continue a capital spending plan. Navy MWR has also initiated a cost containment assist visit program that has provided advice and support to more than 25 commands in the past year and identified savings of over \$6 million. Finally, MWR has tightened financial standards, controls and the budgetary system to identify and effect operating corrections in the field.

QUALITY OF LIFE INITIATIVE

Chairman: Please describe the Quality of Life initiative of the Department of Defense (DoD) and what is the role of Morale, Welfare and Recreation (MWR) in this program. Has there been any increases in funding for MWR programs as a result of this policy?

Admiral Marsh: On 10 November 1994, the Secretary of Defense announced an initiative which will provide \$2.7 billion over six years (96-01) for quality of life programs. A Quality of Life Task Force was created, chaired by former Secretary of the Army John Marsh. The focus of this Task Force is to generate practical ideas that can be implemented quickly to improve quality of life. This includes identifying required budget actions; identifying ways of improving personnel tempo/reducing turbulence; exploring DoD-wide standards for quality of life; and finding key areas where appropriated funds could be used to improve quality of life quickly. The Task Force is expected to make their overall recommendations to the Secretary of Defense in September 1995.

Program Decision Memorandum (PDM) III, which distributed the initial funds for the Department of Defense's (DoD) quality of life initiative, provided Navy MWR with \$8.1 million per year for child development programs for FY-96 and out. These funds will be used to test an outsourcing concept for child development spaces in fleet concentration areas which should increase program capacity. This action continues a test requested by Congress in the FY-95 Defense Authorization Act.

PROJECT VALIDATION

Chairman: The Panel has consistently urged the Department of Defense (DoD) to employ outside consultants to validate the construction requirements for the armed services Morale, Welfare and Recreation (MWR) programs. Are these validations binding or can the services deviate from the consultant's recommendations? Do we need a broader validation of requirements either at the DoD level or at the installation level where Post Exchanges (PX) and all other community service availability are considered in determining whether a project is needed?

Admiral Marsh: Navy does not currently utilize outside consultants to validate construction requirements. However, the Navy MWR/Navy Exchange (NEX) Board of Directors approved a proposal in October 1994 requiring the use of independent consultants to validate all future projects costing in excess of \$1.5 million. Validations will include program needs, market capacity, customer demand, investment analysis (return on investment/internal rate of return), and operational benefit/impact.

Results of independent validation are not binding, but they will have a significant influence on project selection. A new project nomination/assessment process for out-year MWR projects is being implemented that will incorporate three tiers of independent project validation depending on the respective project cost. The lowest tier of assessment would be applied to projects between \$500K and \$700K. Successive degrees/levels of assessment will be coordinated with the type of project involved and cost implication to the overall system. The independent validation process will also be coordinated with the execution and management strategies associated with accelerated accomplishment. This process will be implemented in FY-96.

CHILD CARE

Chairman: We have heard that nearly 60 percent of the total Morale, Welfare and Recreation (MWR) appropriation is now being consumed by military child care and that this represents a large subsidy to a small percentage of the Department of Defense (DoD) people. This is in addition to a hefty subsidy from nonappropriated funds (NAF) for this purpose. What efforts are being taken in DoD to ensure that there is a proper balance between the needs of those people that have children and the requirements of the rest of the people on military bases?

Admiral Marsh: In FY-95, the Navy's MWR operation and maintenance support (O&MN & O&MNR less exchange APF funding) was \$277 million. This includes child care operations and maintenance support of \$70 million (about 25% of total MWR budget). System-wide, the Navy child care program is operating without a NAF fund subsidy.

As a result of the Military Child Care Act of 1989, Navy made a concerted effort to increase APF support for child care without a negative impact on the MWR program. None of the \$65 million plus-up for Navy MWR in FY-94 was directed at child care programs.

In Navy, 42.3% of the service members are married with children. Child care is viewed as a life cycle program which families need for a limited period of time. Although the entire force does not need care at a single point in time, most need it at some time in their career.

BRAC FUNDING

Chairman: What has been the experience in gaining base closure and realignment funding for Morale, Welfare and Recreation (MWR) projects?

Admiral Marsh: The Navy has committed \$27.4 million to Base Realignment and Closure Construction (BRACON) projects (i.e., three Child Development Centers at \$8.0M and other various MWR facilities such as a youth center, a gym, playing fields at \$19.4M).

RESIDUAL VALUE FUNDING

Chairman: The U. S. was supposed to realize a substantial gain from the sale of facilities at closed overseas bases. Have any of these proceeds been realized and, if not, why not?

Admiral Marsh: In only two recent instances, Australia and Holy Loch, did the U. S. government (Navy) receive compensation (i.e., approximately \$2.2M) from realignment actions at an overseas location. In both situations, the compensation received came from the disposition of improvements to privately owned leased property vice foreign government land. Compensation for improvements on foreign government owned land has not occurred. Such requests have been countered by restoration and environmental claims. There is little incentive for foreign governments to offer compensation for improvements to property they already own.

INVESTMENT OVERSIGHT

Chairman: What were the results of the most recent Department of Defense (DoD) investment oversight review? Given the decentralized nature of the DoD Morale, Welfare and Recreation (MWR) system, how can DoD ensure that installations are not using excess cash on new facilities that will not provide a good return on investment?

Admiral Marsh: The Navy MWR headquarters Certified Public Accountant's (CPA) audit report for the last fiscal year includes an audit of our investment program. This report stated that Navy's investment program was professionally managed and controlled and that there were no discrepancies noted.

While commanding officers have the authority and flexibility to make some capital investments to maintain and modify programs to respond to the needs of military personnel, they are required to obtain higher level approval for projects of \$200,000 or more. These are evaluated by major claimants, the Navy MWR Program Manager, and reported to the Office of the Secretary of Defense. Congressional review and approval of construction projects over \$500,000 is currently required.

Navy commanding officers are responsible for ensuring that nonappropriated fund (NAF) resources are protected and used wisely. As in the appropriated fund area, the chain of command reviews how funds are spent

through on-site visits and reports. The commanding officer and the chain of command are provided monthly a set of financial statements, so that they can exercise oversight and evaluate and analyze the financial results of the MWR operations.

MWR projects nominated for funding first reflect the local command priorities as recommended by the MWR Director and approved by the commanding officer. The highest priority project "needs" are identified through a combination of patron survey results, focus groups, condition of existing facilities, and other off-base recreation and club opportunities. If local nonappropriated funds are available, commanding officers can authorize NAF funding up to \$200,000 for construction requirements.

NAVY MWR FUNDING

Chairman: We have heard disturbing reports that the Navy's Morale, Welfare and Recreation (MWR) program is in a declining financial state. In fact, reduced dividends and other policies have forced some bases into a negative financial condition. Is this so, and what is being done to remedy this condition?

Admiral Marsh: The Navy's MWR Program is in sound financial condition and is effectively adjusting to a reduced sized military force and smaller exchange profit distributions. The Navy-funded \$65 million appropriated fund (APF) plus-up in FY-94 helped MWR turn the corner.

In addition, other significant actions have been taken to achieve the improvement and sustain the financial health of our program as noted below. There has not been an increase in bases that are experiencing negative financial conditions in FY-95. In fact, as of May 1995, only one base has a negative cash position and it has a plan in place to get well.

Navy has undertaken aggressive action to reduce overhead costs and right sizing our MWR program scope and support structure consistent with the smaller Navy we will support in the future. The Navy recently developed MWR program guidelines by size of installation, base population, and priorities of MWR customers. These program guidelines define minimally acceptable "core" programs and are used for short/long range program planning, budgeting, and facility requirements. These guidelines also help managers determine which programs to promote, slim down, or eliminate in a downsizing environment.

The Navy has fine-tuned patron survey instruments (e.g., an annual overall Navy Personnel Survey, the Navy Leisure Needs Assessment, and local surveys) to ensure that Naval personnel have input on program priorities. These surveys help commands deliver high quality cost effective MWR programs consistent with the size of the operation and needs of the patrons.

The Navy is focusing on some key MWR program initiatives that have already shown promise:

- MWR is generating more interest, higher usage, and greater profit in leisure travel programs. Navy is expanding services in this profitable area with both central and local marketing initiatives.

- With the support of the Office of the Secretary of Defense and the Congress, Navy was successful in reducing the APF parity gap with the other Services in 1994 and has sustained its funding baseline. An additional \$65 million in APF funds are being used to help support essential MWR programs.

- Navy MWR is becoming involved in more central contracting of common-use items in conjunction with the Air Force Nonappropriated Fund Procurement Office (AFNAFPO). Past participation in the AFNAFPO programs has resulted in a savings of approximately \$2 million per year for Navy MWR activities.

- MWR has taken effective advantage of commercial sponsorship initiatives which have provided needed support for many MWR special events and increased cooperative involvement between the Navy, public and commercial sectors.

- For our club system, we have developed a comprehensive food, beverage and entertainment master planning process now in use by our bases to objectively determine base-wide food and beverage needs of authorized patrons, now and in the future, as base populations may change. The master planning process quantifies what the base population can support and facilitates decisions as to which operations need to be opened, closed or changed to remain viable and meet customer needs.

- Financial standards have been instituted for Navy clubs, golf courses and bowling programs. These MWR activities must achieve minimum gross profit margins, maximum labor percentages, and maintain profitability standards (e.g., 3 percent for Category B bowling centers and 5 percent for golf courses). This has resulted in improvement in overall system profits and the closure or consolidation of 74 clubs since 1991. Two nine-hole golf courses have also been closed.

- In the child care area, Navy emphasizes the need to operate quality child development programs in a business-like manner and has provided training to program administrators in budgeting and cost control. A review of operating efficiency is included in the annual inspection. The result is an outstanding child care program that operates without a NAF subsidy. Since family child care is a cost effective means of

delivering child care services, the Navy is taking steps to expand family child care where feasible. Each echelon II command is required to submit a detailed monthly report specifying direct APF support, income from parent fees, NAF expenses and personnel information to ensure child care operations comply with Navy and DoD funding policy.

- The Bureau of Naval Personnel MWR headquarters has initiated a quarterly APF reporting requirement by claimant to monitor the extent to which MWR activities are executing their appropriated funds. This information is of particular interest to the Vice Chief of Naval Operations chaired MWR/Navy Exchange Board of Directors. It is their clear intent to protect the \$65 million APF plus-up by ensuring the funding is being executed as intended.

- The MWR/NEX Board of Directors maintains continuing oversight over policy and financial trends so they can make strategic decisions on funding, policy, and operating issues.

CONSOLIDATIONS

Chairman: We understand that the Navy Exchanges (NEX) and Morale, Welfare and Recreation (MWR) programs have embarked on some consolidations. Can you describe how this program is proceeding and what improvements have been realized?

Admiral Marsh: MWR and NEX have undertaken several joint financial and administrative common support efficiencies at many bases over the past three years. These consolidations were initiated wherever it made good business sense to do so.

We have essentially completed the implementation process on these consolidations and are basically pleased with the results. Specifically, expense reductions have been obtained from MWR and NEX common support consolidations such as nonappropriated (NAF) Vehicle and Facilities Maintenance, NAF Procurement, common cashier cages and shared NAF Personnel/Payroll offices.

CONSTRUCTION

Chairman: It appears that there are certain functions that lend themselves to cooperation where the taxpayer could benefit without reducing the benefits provided to military people. One example appears to be cooperation in the use of facilities and personnel between Department of Defense schools (DoDDS) in the United States and overseas and the various youth programs of the DoD. Several years ago, the panel suggested that it would be advisable under certain conditions to take advantage of this opportunity. What progress has been made on this panel recommendation?

Admiral Marsh: The Navy Morale, Welfare and Recreation (MWR) Program Manager has encouraged activities to seek joint opportunities with Department of Defense Schools (DoDDS), surrounding communities and organizations such as the YMCA, YWCA, and the United Services Organization to supplement on-base programs. Many local level cooperative programs are currently being operated and include: sports and fitness programs; joint use of athletic facilities; use of school gymnasium and classrooms for dances and social events and skills classes; joint programs offered for camp outs, overnight trips, outdoor recreation programs and intercultural events.

The Navy is developing a guide to partnership agreements with other organizations to operate Before and After School programs where it makes sense. This effort would include potential use of DoDDS facilities.

INVESTMENTS

Chairman: It has long been the panel's position that cash should not be held for investment sake and that the earnings from the programs should be used to build new facilities and provide better programs. Toward this end, we have mandated centralized management of cash to accelerate the movement of profits to the intended recipients. How is this process going? What are its benefits and its drawbacks?

Admiral Marsh: Navy's Morale, Welfare and Recreation (MWR) program does not hold cash for investment sake. In fact, Navy MWR accumulates all cash in central investment accruals and does not distribute investment earnings to the field for the specific reason that we do not want to provide local activities an incentive to build up cash balances to earn income. Furthermore, cash balances are closely monitored and considered in the Navy-wide nonappropriated fund (NAF) MWR budget process and are a major criteria in determining the need for operational or capital funding support.

Navy MWR took action to centralize underutilized NAF field cash in FY-93, causing a total of \$65 million to be put to work for capital requirements consisting of \$28 million for centrally managed projects and \$37 million for local projects, which were reviewed and approved by major claimants and the Bureau of Naval Personnel. Since that time, MWR field activity cash balances have been closely controlled through a comprehensive annual budget review process. We have consistently maintained a one to one central cash to obligations ratio and a field cash ratio of 1.5 to 1 to accommodate monthly variations in the business cycle and avoid interruptions in service to Sailors during periods of reduced income.

In summary, the centralized cash management system provides the necessary oversight to leverage the use of available cash through the budget process and the needs test employed in allocating operational subsidies. Navy centralized underutilized NAF system cash in FY-93 and has sustained a much lower NAF field cash balance since then.

PUBLIC/PRIVATE VENTURES

Chairman: What has been the experience with regard to public and private ventures (PPV)?

Admiral Marsh: Navy Morale, Welfare and Recreation (MWR) has executed one major PPV initiative. This was a multi-plex 10 screen movie theater at Naval Station, Norfolk, Virginia. It is a profitable operation for MWR. We had planned to advertise for another PPV movie theater in San Diego. However, this

initiative along with several others were placed on hold by the Navy's Office of General Counsel after a question arose regarding the legislative authority needed to retain nonappropriated fund (NAF) profits locally from PPVs. We are in the process of proposing an initiative to the Office of the Secretary of Defense (OSD) to write new legislation which will permit retention of profits by the MWR Program which are derived from lease agreements with the private sector. Now, profits generated from PPV lease agreements must be turned in to the U.S. Treasury.

Areas where we will be considering future PPVs include marinas, car washes, and golf courses.

ON-BASE COMPETITION

Chairman: What efforts are made to ensure that there is not undue competition among Morale, Welfare and Recreation (MWR) programs and Post Exchanges (PX) on military bases?

Admiral Marsh: To ensure that conflicts are minimized, Navy follows the Department of Defense (DOD) policy which sets forth the separate responsibilities of exchange and MWR activities for resale operations on military bases. Navy MWR and Navy Exchange (NEX) program officials also meet regularly to work out specific concerns as they arise.

The only area of significant potential overlap has been with food. We have worked out ground rules in this area: 1) Each program basically operates the food operations in its management facility and exchanges contract for commercial off base services (e.g, McDonalds); 2) The commanding officer is empowered to identify and eliminate or consolidate operations (MWR or NEX) to avoid wasteful competition. This has been beneficial for both programs; 3) MWR and NEX commenced using a joint food, beverage and entertainment survey of bases this year. This survey tells us which should be closed; 4) The Navy MWR program's "Red Flag" system identifies to major claimants/and base commanding officers those clubs which are experiencing significant losses. The system requires an action plan to correct the problem.

Question: Would each of you describe the fiscal year 1996 budget request for MWR? In which areas are there program increases and decreases, and does this represent any change in priority?

BGen Joy: The Fiscal year 1996 appropriated fund (APF) budget includes \$69.9 million in O&MMC, \$17.4 million in MPMC, and \$7.5 million for Child Care in MILCON requirements. The O&MMC budget includes \$18.2 million for the child development program.

Recent Quality of Life funding initiatives have resulted in substantial increases for our programs. PBD 708 provided \$10 million in FY95. MC POM 96 and PDM III provided \$40 million a year for FY96 through FY01. These increases enable Marine Corps MWR funding to be comparable with the other services funding of MWR.

The Marine Corps Full Time Equivalency (FTE) budget has been adjusted to allow for the conversion of 650 Category A and Category B nonappropriated (NAF) billets to APF billets. The conversions began with 125 billets in FY95. The remaining billets will be converted during FY96 through FY98.

We have earmarked \$14 million of the FY96 and FY97 funding increase for badly needed repairs and modernization of gyms, physical fitness centers, libraries, and barracks recreation rooms. Another \$14 million will be used to support new and improved exercise equipment for gyms and fitness centers, recreation and athletic equipment; and state of the art technology systems, equipment, and supplies for our libraries.

Our priority is to continue to enhance the delivery of MWR through program and facility improvements.

We have learned that dividends from the exchange services have been reduced due to force structure reductions and reduced sales.

Question: Would each of you please describe the extent of these decreases on your programs and what has been the impact? How do you intend to make up for these shortfalls?

BGen Joy: The Marine Corps has not been seriously affected by base closures or significant rightsizing. As a result, our exchange sales and earnings have increased each year. Our 1994 sales increased 1 percent over prior year and earnings increased 3 percent. To further improve our operating results, we plan to implement a state-of-the-art merchandise information system and centralize various overhead functions such as accounting, personnel, training, and buying. These actions will reduce operating expenses and enable us to maintain and further improve our funding for MWR programs.

Question: What has been the experience in gaining base closure and realignment funding for MWR projects?

BGen Joy: The Marine Corps has realized no funding for MWR projects as a result of base closure or realignment.

The U.S. was supposed to realize a substantial gain from the sale of facilities at closed overseas bases.

Question: Have any of these proceeds been realized and, if not, why not?

BGen Joy: The Marine Corps has not realized any gain from the sale of closed overseas bases. At the end of FY94, Marine Corps Exchange facilities located in Panama were transferred to AAFES, but not sold.

The panel is concerned that there continues to be a disparity among the armed services over the treatment of their people. It appears that, despite congressional increases in appropriations, the Navy continues to come up short on its funding. And, that this policy has the practical effect of having the Navy keep cigarettes out of its commissaries so that Sailors can only buy them in exchanges. To make matters worse, Sailors also have to pay a higher mark-up in exchanges for these products than their counterparts in the Army and Air Force.

Military people make the same amount of money regardless of the branch of the armed service to which they are assigned.

Question: Therefore, don't we need a consistent policy throughout for pricing items?

Question: How do you reconcile this pricing disparity and what do you intend to do to address it?

BGen Joy: The Marine Corps does not believe that the American taxpayer wants to subsidize the sale of cigarettes in the military commissaries by selling them at cost to our military personnel. This is also diametrically opposed to the government and Department of Defense's efforts to deglamorize tobacco products due to their harmful and habit forming effect on the consumer. We, therefore, have taken the position to continue to make cigarettes available to those who choose to smoke, but only in exchanges where the taxpayers money is not used and where profits are used to support healthful MWR programs. We would encourage all services to do the same.

It appears that there are certain functions that lend themselves to cooperation where the taxpayer could benefit without reducing the benefits provided to military people. One example appears to be cooperation in the use of facilities and personnel between DOD schools in the United States and overseas and the various youth programs of the DOD. Several years ago, the panel suggested that it would be advisable under certain conditions to take advantage of this opportunity.

Question: What progress has been made on this panel recommendation?

BGen Joy: The Marine Corps has only three stateside DOD school systems on commands with MWR Youth Programs; MCB Camp Lejeune, MCAS Beaufort, and MCCDC Quantico. Since our youth program is organized for youths both on and off base, our youth programs coordinate many initiatives and share space with school systems in their surrounding geographical locations. Some space examples are as follows: School gyms (events, sports, dances and youth recreation classes); MWR and school fields for athletic and sports events, special events and fun and fitness activities; and recreation facilities for picnics, parties, school P. E., swimming and bowling classes. Additionally, the schools and youth programs at many sites coordinate their major annual activity schedules and distribute youth program information. As we develop our newest program, the teen program, we hope to share more.

It has long been the panel's position that cash should not be held for investment sake and that the earnings from the programs should be used to build new facilities and provide better programs. Toward this end, we have mandated centralized management of cash to accelerate the movement of profits to the intended recipients.

Question: How is this process going? What are its benefits and its drawbacks?

BGen Joy: The Marine Corps has complied with the Panel's mandate to centralize the management of cash to accelerate the movement of profits to the intended recipients. Cash totalling \$21 million was taken from local command investments in FY95.

The benefits of this action are a cross leveling of funds to the greatest need and the excess funds used for needed capitalization requirements, not just drawing interest. The drawback is that if we are too aggressive in our cash use we could place our installations in a cash flow problem.

Question: What has been the experience with regard to public and private ventures?

BGen Joy: The Marine Corps has had limited experience and success with public/private ventures (P/PV). Our best successes have been with fast food ventures. We have one service station being operated as a P/PV and are looking at the possibility of using P/PV for quick automobile lubrication operations. We are currently using a modified approach of P/PV at two commands to have a commercial hotel/motel firm design, build and operate a Temporary Lodging Facility using commercial standards. The Marine Corps is self-funding the construction with nonappropriated funds rather than having a commercial firm finance the projects and thus pass the cost of financing to our patrons.

Question: What efforts are made to ensure that there is not undue competition among MWR programs and PXs on military bases?

BGen Joy: Competition between MWR programs and PXs on Marine Corps bases does not exist because they are all one organization. The Marine Corps consolidated their exchanges, clubs, and recreation activities into one MWR program in 1988.

CONSTRUCTION

Mr. McHugh: It appears that there are certain functions that lend themselves to cooperation where the taxpayer could benefit without reducing the benefits provided to military people. One example appears to be cooperation in the use of facilities and personnel between DOD schools in the United States and overseas and the various youth programs of the DOD. Several years ago, the panel suggested that it would be advisable under certain conditions to take advantage of this opportunity. What progress has been made on this panel recommendation?

General Meyer: Army youth programs are encouraged to work with local schools to provide additional space for before and after school recreation programs, and support school level sports programs. Additionally summer programs are operated using space provided by schools, both in CONUS and OCONUS. Memorandums of Agreements (MOAs) have been established between schools and community programs for recurring programs, using a cost sharing formula for items e.g., maintenance and repair services, custodial services, utilities, and other common support services.

INVESTMENTS

Mr. McHugh: It has long been the panel's position that cash should not be held for investment sake and that the earnings from the programs should be used to build new facilities and provide better programs. Toward this end, we have mandated centralized management of cash to accelerate the movement of profits to the intended recipients.

- How is this process going?
- What are its benefits and drawbacks?

General Meyer: The Army implemented the mandated cash sweep, using 31 October 1994 financial data. Installations had all cash swept above a 2:1 cash to debt ratio. Total funds swept were just under \$73 million. Of this total, \$46.5 million was immediately designated for capital reinvestment (nonappropriated fund [NAF] major and minor construction and associated furniture, fixtures and equipment). As an adjunct to the cash sweep, in FY 96 the Army will begin an assessment program based on installation revenue. These funds will accrue to the Army Morale, Welfare and Recreation Fund (AMWRF). The benefits of this assessment program will be an increase to the AMWRF's ability to have capital for new NAF MWR initiatives and new facilities. The major drawback to this program may be a resentment by local managers that "their funds" are being taken away. However, the Army has established performance standards that, in part, require Installation Morale, Welfare and Recreation Funds (IMWRFs) to operate at a minimum of 5 percent net income before depreciation plus the 2 percent capital reinvestment assessment. Also, the performance standard includes a rating for cash position or fund solvency. The Army believes that placing the same emphasis on excess cash as on insolvency will encourage local managers to refrain from holding funds simply to earn interest.

FISCAL YEAR 1996 NATIONAL DEFENSE AUTHORIZATION, THE EFFECT OF FORCE STRUCTURE DRAW-DOWN ON COMMISSARIES AND EXCHANGES

HOUSE OF REPRESENTATIVES,
COMMITTEE ON NATIONAL SECURITY,
SPECIAL OVERSIGHT PANEL ON
MORALE, WELFARE AND RECREATION,
Washington, DC, Thursday, April 6, 1995.

The Special Oversight Panel met, pursuant to call, at 10 a.m., in room 2212, Rayburn House Office Building, Hon. John M. McHugh (chairman of the Special Oversight Panel) presiding.

STATEMENT OF HON. JOHN McHUGH, A REPRESENTATIVE FROM NEW YORK, CHAIRMAN, SPECIAL OVERSIGHT PANEL ON MORALE, WELFARE AND RECREATION

Mr. MCHUGH. Good morning. We will call the meeting to order. I want to welcome you all here today. This is the second oversight hearing that the Special Oversight Panel on Morale, Welfare and Recreation has held in regard to the fiscal year 1996 national defense authorization.

Clearly, this is an important hearing on a number of accounts. The military resale entities are at a critical stage; downsizing, base closures, defensewide budget problems, and off-base competition provide the imperative for vigilance to ensure that these programs remain available for our military people in the future.

Our military personnel and their families rely heavily upon these programs for these day-to-day products and services. At many locations, particularly those in the overseas areas, alternatives are severely limited. One only needs to look at the dramatic reductions and the value of the dollar against the Japanese yen and the German mark to see how truly critical these programs are.

The purchasing power of our troops on the local economies slide with the value of the dollar. In time of the downturn, they come to rely upon the military outlets more than ever. We also see costs for overseas exchanges and commissaries rise almost proportionately with the decline of the dollar against those currencies.

At the same time, appropriations budget constraints on MWR community programs puts pressure on the exchange services to increase dividends. This trend coincides with the force structure reductions and base closures that lower sales, diminish economies of scale, and ultimately has a major impact on the bottom-line capability of the PX systems.

This is further compounded by the continuing emergency of off-base wholesalers and retail giants in the United States that attract potential exchange consumers. Also, credit programs of these sys-

tems provide a new financial management dimension that demand active oversight.

While the commissary program faces many of the same challenges, there are other dimensions as well. With the heavy reliance on appropriated funds, these stores are vulnerable to the budget axe. It is imperative that the managers of this program continually demonstrate that the level of subsidy that is received is well-managed.

Despite these challenges, there is certainly room and reason for optimism. The economies of scale that can be mustered through greater cooperative efforts and administrative efficiencies can provide the ability to keep the benefit level high, while maintaining or increasing the bottom line and reducing the level of subsidy along with force structure reductions.

The opportunities that are presented by technology can bolster the prospects for the future. Active oversight and continued emphasis by DOD leadership can provide the impetus needed for change and adaptation. The challenges are enormous. This Panel is determined to fulfill its stewardship mandate of ensuring a viable and robust program that meets the needs of our military people today and in the future.

I look forward to hearing from our distinguished panel of witnesses. I hope they recognize, and I'm sure they do, that the critical nature of these challenges exist, and can provide valuable and candid assessments of the current situation and hopefully some creative approaches for meeting the future in a responsible manner.

Today's panel of expert witnesses include: Mr. Fred Pang, Assistant Secretary of Defense for Force Management; Maj. Gen. Richard Beale, U.S. Army, Director of the Defense Commissary Agency; Maj. Gen. Robert Swarts, U.S. Air Force, Commander of the Army and Air Force Exchange Service; Rear Adm. John Kavanaugh, Commander, the Navy Exchange Service Command; and Brig. Gen. James R. Joy, U.S. Marine Corps (Ret.), Director of MWR Support Activity for the U.S. Marine Corps.

Mr. Browder, the ranking member, is on the floor in the House of Representatives taking care of some business there. We will certainly—as I say that, he arrives.

I should wish for money. It might be my lucky day. With that, I will turn the microphone over to the distinguished ranking member, Mr. Glen Browder.

STATEMENT OF HON. GLEN BROWDER, A REPRESENTATIVE FROM ALABAMA, RANKING MINORITY MEMBER, SPECIAL OVERSIGHT PANEL ON MORALE, WELFARE AND RECREATION

Mr. BROWDER. Thank you, Mr. Chairman.

I apologize for being a little late. I thought I was going to play it smart and be on the floor of the House to vote on the journal immediately at 10 o'clock. Of course, they took that opportunity to call no journal vote.

Mr. Chairman, we are pleased to have these gentlemen here before us today. I look forward to their testimony. I commend and share your interest in meeting the challenges facing this system. The financial foundation of this program must be maintained if we

are going to ensure that our military continues to be the beneficiary of this wide range of benefits.

You have summarized very well the nature of the problems. The key to ensuring a viable resale system is continually striving to keep patron prices low by generating potential and thereby minimizing reliance on taxpayer subsidies.

If overhead is not reduced and economies of scale are not attained, then the end result can only be increased costs to the patron and a continued obligation of the taxpayer. Threats to the system enlarge as the Congress and the administration move to economize the Government at large.

As the threats and pressures mount, the link between appropriations and the system's ability to reduce overhead and maximize revenue potential is strengthened. Inefficiency through parochialism cannot be tolerated if we are to protect the interest of the taxpayer and the patron. Thank you.

Mr. McHUGH. I thank the gentleman.

We will open up the panel this morning with comments from Secretary Pang. Mr. Secretary, welcome.

STATEMENT OF FRED PANG, ASSISTANT SECRETARY FOR FORCE MANAGEMENT, DEPARTMENT OF DEFENSE

Mr. PANG. Mr. Chairman, Mr. Browder, and members of the Panel, I welcome the opportunity to appear before you, along with my colleagues from the Defense Commissary Agency and the Military Exchange Services to discuss our commissary and exchange operations.

My written statement covers these programs and has been submitted for the record. With your permission, Mr. Chairman, I would like to highlight its points. Military commissaries and exchanges have existed in some form nearly as long as we have had a military. Their function has evolved as has the composition of our forces.

Today, they are a very valuable nonpay benefit to our people, their families, and our retirees. Indeed, service members rank the commissary benefits second only to military health care. The exchange benefit is not far behind. Our commissary operations were consolidated under the Defense Commissary Agency, DeCA, in October 1991. Prior to that, the military services operated their own commissary systems.

Commissaries were consolidated to effect efficiencies and to improve the delivery of services to patrons. I am pleased to report that the consolidation will produce efficiencies in the form of appropriated fund savings. At the same time, customer satisfaction continues to improve.

Our commissary system is operating not only more efficiently, but more effectively. I want to add that this work is still in progress. I know that General Beale will discuss with you initiatives that are underway or planned that will further streamline our commissary operations.

Secretary Perry recently reaffirmed his support for maintaining the commissary benefit at its current level; a savings to consumers on the order of 20 to 25 percent for goods they purchase. Our peo-

ple not only save, but are provided with convenient shopping at many locations that are far removed from access to grocery stores.

In certain locations, such as overseas, they are the only place our people can find familiar American products. Similarly, the exchanges also provide our people and their families with a valuable benefit in savings to patrons. Exchange profits also return dividends to our morale, welfare, and recreation programs. For example, last year they returned \$283 million to the morale, welfare, and recreation programs that support our people and their families.

I think it is important to underscore this point because it is not the taxpayers' money that we are talking about, but the money of our soldiers, sailors, airmen, and marines which help to self-fund morale, welfare, and recreation activities.

As with our commissary operations, we continue to seek ways to improve our exchange operations by making them more efficient and effective. Our exchange service representatives on this panel will elaborate on initiatives that are underway or planned.

Mr. Chairman, I discuss in my written statement actions we recently have taken to improve our civilian oversight of commissary and exchange operations. For example, we have tightened up our credit, and we are revising investment rules to protect our funds as well as our customers.

We have encouraged greater cooperation and sharing between the commissary and exchange services to reduce overhead. At the same time, we have been sensitive in our approach to ensure that we balance our oversight responsibilities with the realities of these centralized operations.

Mr. Chairman, I want to conclude by saying that I look forward to working with this Panel in keeping our obligation to our people and sustaining our commissary and exchange benefits, while at the same time seeking greater efficiencies in operations. This Panel has guided and supported us in this regard over the years. Our service members and their families greatly appreciate your support.

Mr. Chairman, this concludes my statement. I am prepared to respond to any questions you may have.

STATEMENT OF THE

HONORABLE FREDERICK F.Y. PANG

ASSISTANT SECRETARY OF DEFENSE
FOR FORCE MANAGEMENT POLICY

BEFORE THE

MORALE, WELFARE AND RECREATION PANEL

OF THE COMMITTEE ON NATIONAL SECURITY

UNITED STATES HOUSE OF REPRESENTATIVES

APRIL 6, 1995

GOOD MORNING MR. CHAIRMAN AND MEMBERS OF THE MORALE, WELFARE AND RECREATION PANEL. THANK YOU FOR THE OPPORTUNITY TO AGAIN APPEAR BEFORE YOU TO DISCUSS THE DEPARTMENT'S RESALE PROGRAMS. OUR EXCHANGE SERVICES AND COMMISSARY PROGRAM ARE VITAL TO THE SUCCESS OF THE DEPARTMENT.

IN MY EARLIER TESTIMONY TO THE PANEL DURING THE MWR HEARINGS, I SPOKE ABOUT THE SUCCESS OF THE POST-COLD WAR DRAWDOWN, SECRETARY PERRY'S AMBITIOUS QUALITY OF LIFE INITIATIVE, AND OUR MORALE, WELFARE, AND RECREATION PROGRAM. TODAY I WILL ADDRESS THE DEPARTMENT'S EXCHANGE AND COMMISSARY PROGRAMS. I WILL COVER SEVERAL INITIATIVES BEING UNDERTAKEN IN SUCH AREAS AS COOPERATIVE EFFORTS, NEW BUSINESS VENTURES, AND PLANNING TO BECOME MORE EFFICIENT AND EFFECTIVE. ALL OF THESE ACTIONS ARE VITAL PARTS OF THE DEPARTMENT'S OVERALL PROGRAM OVERSIGHT.

I WOULD LIKE TO POINT OUT THAT THE EXCHANGE AND COMMISSARY PROGRAMS ARE COMPLEX SYSTEMS THAT DIRECTLY IMPACT RETENTION AND THEREFORE THE READINESS OF OUR FORCES. THE SUCCESSFUL DELIVERY OF THE QUALITY OF LIFE PROGRAMS CAN NOT BE ACHIEVED WITHOUT HIGH QUALITY EXCHANGE AND COMMISSARY PROGRAMS. WE ARE IN THE PEOPLE BUSINESS AND THE DOWNSIZING EFFORT HAS CAUSED US TO REVIEW THE ROLES AND MISSIONS OF THE RESALE COMMUNITY

AND HOW WE DELIVER THESE PROGRAMS. OUR REVIEW HAS REINFORCED OUR VIEW OF THE BENEFITS TO BE GAINED FROM COOPERATIVE EFFORTS BETWEEN THE EXCHANGE SERVICES, DECA AND OUR MWR PROGRAMS. THESE THREE SYSTEMS ARE INTERRELATED. THIS IS IMPORTANT SINCE, IN MOST CASES, CHANGES TO ONE SYSTEM WILL CAUSE AN IMPACT OR REACTION TO THE OTHER TWO.

IN RECENT YEARS, SEVERAL STUDIES HAVE BEEN CONDUCTED TO REVIEW AND ANALYZE VARIOUS FORMS OF CONSOLIDATING OUR EXCHANGE SERVICES OR OUR COMMISSARY SYSTEMS. THE COMMISSARY CONSOLIDATION HAS CLEARLY DEMONSTRATED THAT CONSOLIDATION WORKS FOR THE DEPARTMENT'S COMMISSARIES. HOWEVER, AFTER INTENSIVE STUDY, THE DEPARTMENT MADE A DELIBERATE DECISION IN 1991 NOT TO CONSOLIDATE THE EXCHANGE SERVICES. RATHER, WE CHOSE TO SAVE MONEY AND INCREASE EFFICIENCIES THROUGH COOPERATIVE INITIATIVES AND ORGANIZATIONAL CHANGES AS DISCUSSED IN OUR "REPORT ON MILITARY EXCHANGE COOPERATIVE EFFORTS." OUR DECISION WAS SOUND -- REDUCING OVERHEAD AND SEEKING COOPERATIVE EFFORTS TO INCREASE EFFICIENCY, ENCOURAGING COMPETITION, STANDARDIZING -- HAS PAID OFF. OUR EXCHANGES HAVE BECOME "LEAN AND MEAN." PATRON SATISFACTION IS HIGH. TODAY I WILL DISCUSS MANY OF THE COOPERATIVE EFFORTS THAT ARE ONGOING AND RELATE SEVERAL SUCCESS STORIES.

WE ARE REVIEWING THE RESALE PROGRAMS IN THE FACE OF A DECLINING PATRON BASE AND INCREASING COMPETITION WITHIN THE RESALE INDUSTRY. THE CURRENT QUALITY OF LIFE INITIATIVE INCLUDES THE EXCHANGE AND COMMISSARY PROGRAMS. OUR SERVICEMEMBERS AND THEIR FAMILIES REINFORCE THE IMPORTANCE OF THESE RESALE PROGRAMS. THE COMMISSARY BENEFIT IS SECOND ONLY TO HEALTH CARE AS A NON PAY ELEMENT OF THE TOTAL MILITARY COMPENSATION PROGRAM. THE EXCHANGE OPERATIONS ALSO PROVIDE SAVINGS FOR SERVICEMEMBERS AND MILITARY FAMILIES. IN ADDITION, THE EXCHANGES PROVIDE RESOURCING FOR THE DEPARTMENT'S MWR PROGRAMS, AGAIN A VALUED NON PAY COMPENSATION BENEFIT.

WITH THIS AS BACKGROUND, LET ME NOW DISCUSS THE CURRENT STATUS OF OUR TWO MAJOR RESALE PROGRAMS, EXCHANGES AND COMMISSARIES. THESE PROGRAMS ARE A MAJOR FACTOR IN THE QUALITY OF LIFE OF THE MILITARY COMMUNITY.

EXCHANGE SERVICE PROGRAMS

I WILL BEGIN WITH THE EXCHANGE PROGRAMS. THESE PROGRAMS HAVE THE DUAL MISSION OF PROVIDING AUTHORIZED PATRONS WITH MERCHANDISE AND SERVICES NECESSARY FOR THEIR HEALTH, COMFORT, AND CONVENIENCE AND PROVIDING A SUPPLEMENTAL SOURCE OF

FUNDING FOR THE DEPARTMENT'S MWR PROGRAMS. CORPORATELY, THE EXCHANGE SERVICES PAID OVER \$278 MILLION IN DIVIDENDS TO DEPARTMENT MWR PROGRAMS IN FISCAL YEAR 1994. THIS IS BASED ON SALES IN EXCESS OF \$9.5 BILLION DURING THE SAME PERIOD.

EXCHANGES ARE THE PRIMARY SOURCE OF NONSUBSISTANCE RESALE MERCHANDISE AND SERVICES FOR AUTHORIZED PATRONS ON OUR INSTALLATIONS. IN ADDITION, OVERSEAS EXCHANGES PROVIDE A "TOUCH OF HOME" TO OUR SERVICE MEMBERS WITH AMERICAN MADE GOODS THAT OTHERWISE MIGHT BE UNAVAILABLE.

EXCHANGES ARE CLASSIFIED AS REVENUE GENERATING PROGRAMS AND OPERATE PRIMARILY WITH NONAPPROPRIATED FUNDS GENERATED FROM THEIR BUSINESS OPERATIONS. EXCEPT FOR A RELATIVELY SMALL AMOUNT OF APPROPRIATED FUNDS PROVIDED FOR TRANSPORTATION FOR OVERSEAS MERCHANDISE, MILITARY COMMAND AND CONTROL FUNCTIONS AND A LIMITED AMOUNT OF FUNDS FOR BASE REALIGNMENT AND CLOSURE COSTS, THE EXCHANGES ARE SELF SUFFICIENT.

OUR EXCHANGES CONTINUE TO REORGANIZE TO REDUCE OVERHEAD. THEY ARE LOOKING AT STAFFING ABOVE THE STORE LEVEL, EVALUATING THE SIZE AND SCOPE OF REGIONS, AND MOVING TO MORE AUTOMATED PROCESSING TO ACHIEVE FURTHER EFFICIENCIES.

COMMISSARY PROGRAMS

NOW I WILL TURN TO THE SECOND MAJOR RESALE ACTIVITY -- THE COMMISSARY. COMMISSARY OPERATIONS ARE UNDER THE CONTROL OF THE DEFENSE COMMISSARY AGENCY (DECA). THEIR MISSION IS TO PROVIDE AN EFFICIENT AND EFFECTIVE WORLDWIDE SYSTEM OF COMMISSARY STORES FOR THE SALE OF GROCERIES AND HOUSEHOLD SUPPLIES AT THE LOWEST PRACTICAL PRICE TO AUTHORIZED PATRONS. AT THE SAME TIME THE COMMISSARY MUST MAINTAIN HIGH STANDARDS FOR QUALITY, FACILITIES, PRODUCTS, AND SERVICES.

SECRETARY PERRY HAS REPEATEDLY AFFIRMED HIS SUPPORT FOR THE COMMISSARY PROGRAM. THE SECRETARY HAS STATED HE WOULD REJECT PROPOSALS WHICH LOWER THE QUALITY, THE BENEFIT, OR THE SERVICE BEING DELIVERED BY THE COMMISSARY SYSTEM. OF COURSE, IN THE CURRENT TIGHT BUDGET ENVIRONMENT WE WILL CONTINUE TO SEEK MANAGEMENT IMPROVEMENTS, BUT NOTHING THAT WOULD ERODE THE BENEFIT TO OUR SERVICEMEMBERS.

THE CREATION AND CONTINUING IMPROVEMENT IN THE DEFENSE COMMISSARY AGENCY HAS BEEN A MAJOR SUCCESS STORY. DURING ITS SHORT EXISTENCE, DECA HAS GAINED THE RESPECT OF ITS CUSTOMERS AND SUPPLIERS.

THE ORIGINAL JONES COMMISSION PROJECTED THAT ESTABLISHMENT OF A DEFENSE COMMISSARY AGENCY COULD SAVE OVER \$90 MILLION. THROUGH REORGANIZING AND RE-ENGINEERING, DECA STREAMLINED COSTS AND BY THE END OF FISCAL YEAR 1996, WILL HAVE SAVED OVER \$340 MILLION. THEY HAVE ALSO IMPROVED OPERATIONS, ENHANCED CUSTOMER SATISFACTION AND HAVE MADE DOING BUSINESS WITH THE GOVERNMENT SIMPLER FOR INDUSTRY. IN FACT, SEVERAL OF THEIR INITIATIVES SUCH AS DELIVERY TICKET INVOICING AND THE RESALE ORDERING AGREEMENT, WHICH GENERAL BEALE WILL ADDRESS IN MORE DETAIL, ARE MODEL PROGRAMS FOR FURTHER SAVINGS ELSEWHERE IN THE DEPARTMENT.

DEPARTMENT OVERSIGHT

DOD EXECUTIVE RESALE BOARD AND COOPERATIVE EFFORTS:

AS I REPORTED TO YOU DURING THE MWR HEARINGS, WE HAVE RECONVENED THE DOD EXECUTIVE RESALE BOARD. THE EXCHANGE SERVICES AND DECA PLAY A VITAL ROLE ON THE BOARD, COLLECTIVELY EXPLORING RESALE MANAGEMENT OPPORTUNITIES TO MORE EFFICIENTLY AND EFFECTIVELY MANAGE RESALE BUSINESSES.

I PREVIOUSLY REPORTED TO YOU OUR ACTIONS ON COOPERATIVE EFFORTS FOR DELIVERY OF PROGRAMS AND SERVICES. THE RESALE COMMUNITY HAS BEEN THE DEPARTMENT'S LEADER IN COOPERATIVE VENTURES. I'D LIKE TO CITE SOME EXAMPLES OF HOW OUR EXCHANGES AND DECA ARE WORKING TOGETHER. THE MARINE CORPS USES THE AAFES DEFERRED PAYMENT PLAN (DPP) PROGRAM, NEXCOM IS CONSIDERING THE MARINE CORPS' WORKER'S COMPENSATION SYSTEM, AAFES DEVELOPED BRANDED FOOD CONCEPTS FOR USE BY OTHER EXCHANGES, AND DECA WORKED WITH AAFES ON THEIR POINT OF SALE SYSTEM REQUIREMENTS. COOPERATIVE CONSTRUCTION EFFORTS BETWEEN THE EXCHANGES AND DECA ARE IN THE PLANNING PROCESS AT SEVERAL SITES. THE MWR, EXCHANGE AND DECA COMMUNITIES ARE INVESTIGATING COMMON CHECK VALIDATION SYSTEMS. OUR RESALE ACTIVITIES AND MWR PROGRAM DIRECTORS HAVE IDENTIFIED MANY ONGOING AREAS OF JOINT COOPERATION. WHILE WE HAVE ACCOMPLISHED A LOT, THERE IS MORE TO DO

CONGRESSIONAL CONCERNS

OVER THE PAST YEAR, THE DEPARTMENT RESPONDED TO SEVERAL CONGRESSIONAL CONCERNS. WE RECENTLY REPORTED TO YOU ON THE CREDIT PROGRAMS IN THE EXCHANGES AND THE FINANCIAL HEALTH OF THE EXCHANGE SYSTEMS. BASED ON THIS REPORT, THE DEPARTMENT DEVELOPED A NEW POLICY ON FINANCIAL OVERSIGHT OF THE EXCHANGES AND THEIR CREDIT PROGRAMS. WE ALSO REPORTED ON FUNDING THE COST OF TRANSPORTATION OF MERCHANDISE TO OUR EXCHANGES OVERSEAS. FINALLY, WE ARE IN THE PROCESS OF REVIEWING A REPORT ON THE DISTRIBUTION OF ALCOHOLIC BEVERAGES WITHIN THE EXCHANGE SYSTEMS, ANOTHER REPORT YOU REQUESTED.

EXPANDING STOCK ASSORTMENTS

WE ARE EXPLORING INITIATIVES TO MAKE OUR OPERATIONS MORE EFFICIENT AND EFFECTIVE, INCLUDING THE REFORM OF THE COST PRICE AND CATEGORY LIMITATIONS ON OUR STOCK ASSORTMENTS. WE WILL CONTINUE TO WORK WITH YOU TO ENSURE THE BEST QUALITY SERVICE IS PROVIDED TO CUSTOMERS OF OUR RESALE ACTIVITIES.

NEW BUSINESS INITIATIVES

WITH THE DOWNSIZING AND ASSOCIATED SMALLER PATRON BASE, THE DEPARTMENT'S RESALE PROGRAMS MUST SEEK NEW WAYS TO PROVIDE THESE RESALE PROGRAMS TO OUR ACTIVE FORCES AND WHERE POSSIBLE

"KEEP THE PROMISE" TO THOSE WHO HAVE RETIRED. WE HAVE REVISED THE POLICY FOR EXCHANGE OPERATIONS AT CLOSED OR REALIGNED INSTALLATIONS. ONE KEY HERE IS TO PROVIDE EXCHANGE SERVICES TO RESERVISTS WHO REMAIN IN THE AREA. WE ASK THE HARD QUESTIONS BEFORE LEAVING OPERATIONS OPEN -- WILL A RESERVE COMPONENT REMAIN; DOES THE LOCAL COMMUNITY SUPPORT IT; WILL IT BE FINANCIALLY VIABLE, ETC. IF THE ANSWERS ARE "YES" THEN WE WILL ALLOW EXCHANGES TO OPERATE PROGRAMS AT SUCH INSTALLATIONS.

IN ADDITION, AT THE URGING OF CONGRESS, WE ARE TESTING EXCHANGE MARTS AT CLOSURE INSTALLATIONS. THE DEPARTMENT DEVELOPED CRITERIA FOR THE ESTABLISHMENT OF SUCH OPERATIONS. THESE CRITERIA INCLUDE SUCH THINGS AS THE LEVEL OF LOCAL COMMUNITY SUPPORT, A RESERVE POPULATION IN THE AREA, A SUBSTANTIAL NUMBER OF PATRONS WHO WILL BENEFIT, A FULL FINANCIAL PRO FORMA, NO REQUIREMENT FOR APPROPRIATED FUNDS OR NEW CONSTRUCTION, AND SIMILAR FACTORS. WE RECENTLY REPORTED THE RESULTS OF THE FIRST TEST SITE, CARSWELL AFB, TEXAS, NOW KNOWN AS NAS FORT WORTH. WE LEARNED THAT IN THIS CASE, EXCHANGE MARTS DO PROVIDE A VALUABLE BENEFIT FOR RETIREES AND RESERVISTS. THE DEPARTMENT WILL OPEN THE NEXT TEST EXCHANGE MART AT HOMESTEAD AFB, FLORIDA.

THE EXCHANGE MART TEST DEMONSTRATES THAT, IN SPECIFIC SITUATIONS, THIS CONCEPT MAY HAVE POTENTIAL ON CLOSED AND REALIGNED INSTALLATIONS SINCE IT PROVIDES A BENEFIT WITHOUT THE USE OF APPROPRIATED FUNDS. HOWEVER, WE CONTINUE TO CAUTION THAT ANY APPLICATION OF THIS CONCEPT ON ACTIVE INSTALLATIONS COULD SERIOUSLY DEGRADE THE COMMISSARY BENEFIT AND NEGATIVELY AFFECT OUR MWR PROGRAMS. WE WILL CONTINUE TO MONITOR EACH TEST SITE AND REPORT TO YOU THE RESULTS.

IN OVERSEAS AREAS, THE EXCHANGE SERVICES AND DECA HAVE BEEN WORKING COOPERATIVELY TO DELIVER BOTH THE RETAIL AND GROCERY NEEDS OF PATRONS AT SMALLER SITES IN SEVERAL CREATIVE METHODS. WHILE THERE ARE SEVERAL VARIATIONS, BASICALLY EITHER A COMMISSARY WILL SELL A FEW ITEMS FOR THE EXCHANGE OR AN EXCHANGE SHOPPETTE WILL SELL A LIMITED NUMBER OF DECA FURNISHED ITEMS AT COMMISSARY PRICES.

THE DEPARTMENT IS REVIEWING THE DELIVERY OF THE COMMISSARY BENEFIT IN SITUATIONS WHERE ACTIVE DUTY MEMBERS REMAIN ON OR IN THE AREA OF A CLOSED AND REALIGNED INSTALLATION. WE HAVE NOT REACHED ANY CONCLUSIONS, BUT WE ARE SENSITIVE TO THESE

SPECIAL NEEDS AND ARE WORKING TO DETERMINE THE MOST REASONABLE AND APPROPRIATE COURSE OF ACTION.

DOWNSIZING HAS ALSO AFFECTED THE DELIVERY OF SOME HEALTH CARE SERVICES TO SERVICE MEMBERS, FAMILY MEMBERS, RETIREES, AND OUR RESERVES. THANKS TO YOUR HELP, OUR EXCHANGE SERVICES ARE NOW PROVIDING DENTAL, OPTOMETRY AND PHARMACY SERVICES AT LOCATIONS WHERE TRADITIONAL DELIVERY CONCEPTS ARE LIMITED. THESE HEALTH CARE PROGRAMS ARE ADMINISTERED BY THE EXCHANGES UNDER CONTRACT WITH HEALTH PROFESSIONALS FROM THE LOCAL COMMUNITY. INITIAL CUSTOMER RESPONSES INDICATE THIS CONCEPT IS A REAL WINNER. SUCH PROGRAMS ARE GOOD FOR PATRONS, GOOD FOR THE LOCAL COMMUNITY, AND GOOD FOR BUSINESS. WHERE POSSIBLE, WE WILL SEEK TO CONTINUE TO EXPAND THESE ACTIVITIES.

AS I REPORTED TO YOU IN THE MWR HEARING, THE RESALE AND MWR COMMUNITY MET IN EARLY MARCH AND IDENTIFIED ADDITIONAL AREAS FOR CONSIDERATION AS COOPERATIVE BUSINESS OPPORTUNITIES.

FIVE YEAR PLAN

ALLOW ME TO TURN TO ANOTHER AREA OF OVERSIGHT.

UNDERSTANDING THE COMPLEXITIES OF THE OVERSIGHT OF THE RESALE BUSINESS AND THE INTERRELATIONSHIPS BETWEEN THE EXCHANGES

AND THE MWR PROGRAMS, IS VITAL TO INSURING PROPER STEWARDSHIP OF THE RESOURCES AND PROGRAMS. FOR THAT REASON, THE EXCHANGES AND DECA WERE INCLUDED IN THE DEPARTMENT'S FIVE YEAR PLAN WHICH I MENTIONED TO YOU DURING THE MWR HEARING. THE FIVE YEAR PLAN COLLECTIVELY EXAMINES THE RESOURCING REQUIREMENTS, PATRON BASE, PROGRAM VIABILITY, AND CONSTRUCTION PLANS AS A WAY TO ASSESS FUTURE TRENDS IN THESE PROGRAMS. SINCE THE FIRST DRAFT OF THIS PLAN SHOWS THE POTENTIAL USE OF THE TOOL, IT WILL BECOME A RECURRING REQUIREMENT TO AID IN BUSINESS PLANNING.

DEPARTMENT DIRECTIVES

AS WITH THE MWR PROGRAMS, WE HAVE AN INITIATIVE TO REORGANIZE AND UPDATE DEPARTMENT DIRECTIVES FOR THE EXCHANGES AND COMMISSARY. THIS WILL BE ACCOMPLISHED COOPERATIVELY BETWEEN THE SERVICES AND THE DEPARTMENT STAFF. OUR PLAN IS TO POSTURE THESE POLICIES TO MEET THE EVOLVING NATURE OF THE FORCE AND THESE RESALE PROGRAMS.

CONCLUSION

MR. CHAIRMAN, COMMISSARIES AND EXCHANGES ARE AN IMPORTANT COMPONENT OF MILITARY QUALITY OF LIFE. OUR MEN AND WOMEN IN UNIFORM VIEW THESE SERVICES AS AMONG THEIR MOST VALUABLE NON-PAY BENEFITS. IT IS OUR OBLIGATION TO MAINTAIN THIS LEVEL OF CUSTOMER SATISFACTION WHILE OPERATING THESE LARGE, COMPLEX, AND DECENTRALIZED BUSINESSES WITH INCREASING EFFICIENCY. I ASSURE YOU THAT THE DEPARTMENT OF DEFENSE IS COMMITTED TO ACHIEVING THESE TWIN GOALS.

MR. CHAIRMAN, THIS CONCLUDES MY STATEMENT. I WOULD BE PLEASED TO ANSWER ANY QUESTIONS THAT YOU AND THE MEMBERS OF THE PANEL MAY HAVE.

Mr. McHUGH. Thank you very much, Mr. Secretary.

As we did last week, I think the best way to pursue this is to hear the statements of the other members of the witness panel, and then we will go to the general questions.

Also, as we did last week, so as not to upset any rank or seniority issues, I am going to begin on the left end of the table and work my way down. So, with that, General Beale, the floor is yours, sir.

General BEALE. Good choice, Mr. Chairman. It is the only time I can pull rank on these guys.

**STATEMENT OF MAJ. GEN. RICHARD E. BEALE, JR., U.S. ARMY
DIRECTOR, DEFENSE COMMISSARY AGENCY**

General BEALE. Mr. Chairman and members of the Panel, I am pleased to appear before you today. You have my complete statement for the record. I would like to take a few moments to highlight some of the developments of which we are very proud and then remind you of several essential facts about the commissary business.

Over the past year, we have begun organizational streamlining which will save the taxpayer over \$25 million. We have changed the way we purchase and process fresh meat which will save another \$20 million. We are reducing reimbursable cost to the Defense Logistics Agency and the base operations accounts by over \$100 million.

Finally, our inventory costs since consolidation have been reduced by 25 percent, or over \$110 million. I should note that all of these savings have already been accounted for in the defense budget and programs. Most importantly, however, despite all of our cost reduction initiatives, we are still able to provide our customers with outstanding service and savings of almost 25 percent on their grocery bill.

With all of the talk of privatization or consolidation with exchanges, I thought it might be useful to mention a few things that set the commissaries apart from commercial grocery operations and even our resale partners, the exchanges.

First, we sell at cost; There's no profit.

The 5-percent surcharge assessed at the cash register pays about 25 percent of our operations costs, as well as for new equipment, business systems, and construction. Taxpayer dollars cover the balance of our annual costs.

Second, 46 percent of the annual appropriations pays for overseas and remote stateside stores, which account for only 23 percent of our sales.

Third, 80 percent of our sales come from only 43 percent of our stores, which means in the bottom-line-driven arena of competitive grocery markets, 57 percent of our stores would be classified as losers.

The DeCA employees and service members, none of our stores are losers. Each store is a part of the Nation's contract with the Armed Forces. Our job is to provide groceries at cost to service members wherever they are as a part of their total compensation package.

Mr. Chairman, DeCA employees are very proud of what they do, and firmly believe that no one can sell groceries to the American

military community more efficiently or at less cost unless the Nation wishes to reduce appropriated costs by taking money out of service members' pockets.

I, for one, don't believe that is the case. May I remind the Panel that last year DeCA supported disabled Americans with over \$65 million in service contracts, purchased \$690 million from the small business community, and employed over 15,000 military family members worldwide. I would like to report one more amazing fact to the Panel. After an extremely rocky start 3 years ago, DeCA is currently paying over 98 percent of its bills on time. This is over 2 percent above last year's Department of Defense average and demonstrates our commitment to excellence.

Thank you, Mr. Chairman, for this brief opportunity to highlight our accomplishments. I look forward to your questions.

STATEMENT OF
MAJOR GENERAL RICHARD E. BEALE, JR.
DIRECTOR, DEFENSE COMMISSARY AGENCY

BEFORE THE
MORALE, WELFARE AND RECREATION PANEL

OF THE
COMMITTEE ON NATIONAL SECURITY
UNITED STATES HOUSE OF REPRESENTATIVES

FIRST SESSION, 104th CONGRESS

APRIL 6, 1995

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Mr. Chairman and Members of the Panel, I am pleased to appear before you today to update you on the exciting developments occurring within the Defense Commissary Agency. During the last three and one-half years, DeCA has made great strides in gaining the respect and credibility of industry as well as those in Government. We have also maintained faith with our patrons who have earned the indirect pay the commissary provides.

The commissary, which delivers this important segment of service member's total compensation, is in its best condition since Congress first authorized the purchase of groceries at cost in 1826. Yet, like other government entities, we too face the need to reduce costs by streamlining and improving operations while maintaining quality service to all our customers. We understand the challenge. To meet it we are both reorganizing and re-engineering. While re-engineering is the preferred route, it requires a more intensive look at work processes and a two to three year period of time to implement. Consequently, reorganizational changes are being made for the short term to meet downsizing and budget requirements.

A primary objective in achieving efficiencies and economies in the Defense Commissary Agency is to target overhead areas for close scrutiny and to reduce costs where return on investment is marginal. To this end, reorganization of regions, service centers, and headquarters is a major initiative for streamlining. By

September 1997, staffing above store level will be reduced by about 40% from the December 1993 level. The streamlining of our regions will account for over 46% of that reduction.

In general, DeCA's priorities are to streamline regions, streamline headquarters, and streamline commissary operations. To achieve these goals, DeCA has established zone managers, created an Operations Support Center with a Marketing Business Unit, and is assuming certain functions previously accomplished by the Defense Logistics Agency (DLA). These efficiencies move us closer to achieving the commercial supermarket practices in a more cost effective manner without diminishing customer service.

Adopting an industry concept, zone managers were selected, trained, and deployed throughout all regions. Each one-person zone has supervisory responsibility over 5-10 commissaries in the same geographic area. The zone manager is supported directly by both the region and our new Operations Support Center. The zone managers visit commissaries regularly to assist in identifying and solving problems. The primary purpose of the zone manager is to ensure that the patron is receiving full and quality service.

The major reorganization change for the Agency was the creation of an Operations Support Center on December 4, 1994. The Center will provide direct

operational support to commissaries, regions, and zone managers. Many dispersed functions previously conducted either in our regions, in the service centers, or at the headquarters have been consolidated within the Operations Support Center to improve overall operations. An example of this is our consolidation of contract execution functions within the United States. This merger permits the integration of developing requirements, logistics, and contracting functions for operational equipment, supplies, and services in reducing acquisition costs and improving customer service.

One of our great successes continues to be the Marketing Business Unit which was formed in March 1994. Now part of the Operations Support Center, this strategic business unit addresses and resolves operational issues pertaining to electronic commerce, contracting for brand name resale products, merchandising at national levels, cataloging of products to support category management, delivery ticket invoicing (DTI), frequent delivery system (FDS), and electronic passing of pricing information to our front end systems.

By September 30, 1995, we will have assumed several functions currently performed for DeCA by the Defense Logistics Agency (DLA). This realignment of missions, already decremented in the budget, will reduce the DBOF costs to DeCA by approximately \$54 million. As a result of this transfer, DeCA will assume

responsibility from DLA for the requisition and distribution of resale products to be shipped overseas. DLA will continue offshore acquisitions and provide support through their Defense Subsistence Offices by purchasing our fresh fruits and vegetables from strategically sited terminal markets and field crop purchase programs. Military Standard Requisitioning and Issue Procedures (MILSTRIP) requisitions for semi-perishable and perishable brand name product overseas will be eliminated and replaced by the DeCA Overseas Ordering and Receiving System (DOORS). Future contracts for meat, milk, bread, and ice cream will be accomplished by DeCA. DLA brand name supply bulletins are being converted to DeCA Resale Order Agreements (ROAs) which results in a 73 percent reduction in the number of contracts. The ROA simplifies the ordering and payment process. In addition, price changes for those vendors who have ROAs will be downloaded directly to our stores electronically from central DeCA locations.

DeCA has incorporated quality management into its common business practices and principles. DeCA also combines the principles of the Government Performance and Results Act into our quality improvement process. This effort has included partnering with industry to work on the details of business processes that require close coordination between DeCA and our trading partners. Industry has joined us on process action teams (PAT) in both the United States and in Europe to

improve pricing accuracy, distribution of point of sale materials, and product accountability. PAT teams will take the processes we are reengineering and keep looking for ways to improve efficiency while maintaining customer satisfaction.

By partnering with industry, DeCA has embraced the concept of Efficient Consumer Response (ECR) as a core business practice. The DeCA Overseas Ordering and Receiving System (DOORS) to support commissaries overseas was developed through a joint industry, trade association and DeCA team. As mentioned above, DOORS will replace DLA's MILSTRIP requisitioning system overseas commissaries have used for over 30 years. Eliminating MILSTRIP will reduce the order ship time from over 60 to under 30 days. In addition, the on-hand inventory will be reduced by an average of 35 percent because of the increased frequency in ordering and the reduction in order ship time. DOORS deployment begins this month and will be completed in August of this year.

Another important aspect of ECR that DeCA and its trading partners are working to implement is category management. This cutting edge concept is based upon the supplier/distributor/retailer managing selected categories of products as strategic business units by sharing information to develop efficient product assortment, new line-item introduction and product promotions. Industry is partnering with DeCA in the development of objectives and strategies to achieve

DeCA's category goals which will result in a better product mix for our patrons at lower prices.

But perhaps one of the greatest labor savings initiatives implemented by DeCA and industry has been Delivery Ticket Invoicing (DTI). DTI is a payment method whereby the delivery ticket or receipt accompanying each commissary delivery also serves as the invoice or demand for payment. Companies that participate in DTI are no longer required to submit separate invoices for payment. This process has resulted in considerable cost savings for industry, DeCA, and the Department of Defense as virtually all invoice mailing and direct processing costs are eliminated. The DoD Comptroller and the Defense Finance and Accounting Service are extremely interested in the potential DTI may have throughout the Department of Defense.

We are also partnering with the exchanges. DeCA maintains a constant dialogue with both the Navy Exchange and AAFES. Cooperative construction efforts are in the planning stages at Fort Bragg, North Carolina, Port Hueneme, California, and Elmendorf AFB/Fort Richardson, Alaska. We continue to search for additional areas which will provide efficiencies for the total Department of Defense resale community.

I would like to take a moment to update you on our systems modernization efforts. Both our Point of Sale (POS) system and Defense Commissary Information System (DCIS) acquisitions are well under way.

We will be procuring a standardized, proven, commercial off the shelf (COTS) computer system to support our point of sale operations. While it may be an oversimplification, point of sale operations include the cash registers and all of the functions the computer connected to them accomplishes at the front end of the store. This automated system will provide our patrons the same functionality found within the supermarket industry while providing management with real time data. Industry proposals were recently received and are being evaluated. We anticipate fielding the system beginning in fiscal year 1996. This totally non-developmental item (NDI) remains a key investment that will drastically reduce operating costs, modernize DeCA business practices, and integrate the customer checkout function with the business system.

The other key element to support DeCA's reengineering effort is the Defense Commissary Information System (DCIS). Another COTS system, DCIS will provide us the management information the commercial grocery industry uses and the business system DeCA requires. Industry proposals for DCIS have also been received and are under evaluation.

Since fiscal year 1992, 43 major construction projects, including new stores and upgrades of existing stores, have been completed at a total cost of \$290 million. A DeCA team of engineers, architects, and operations specialists devised ways to save up to 10 percent of the cost of an "average" new store construction project. This is being done while increasing functional efficiency and building quality. For their effort, DoD is awarding DeCA the "Team" award for excellence in value engineering initiatives.

DeCA successfully tested concepts aimed at improving the relationships between the government and contractor on commissary construction which parallel those employed in the commercial construction industry. Under this concept, the successful bidder and the Government representatives build a team by agreeing to talk together instead of relying on litigation to resolve construction and contractual problems. In the two projects where we tested the teaming concept (Everett Naval Station and Portsmouth Naval Shipyard), we have found that the resulting cooperation reduced the adversarial relationship that generally develops between the government and its contractor during construction.

The value in which patrons hold the commissary is particularly noticeable when we open new stores or remodel older ones. With 1.5 million square feet of new retail space and another 1.3 million in renovated retail space, we experienced a

tremendous growth in sales in the new and remodeled stores. For example, when the new store at Fort Sam Houston opened, sales exceeded projections by almost \$2 million per month without a corresponding decrease in the other commissaries in the San Antonio area. This demonstrates that when patrons are provided with a modern, pleasant shopping environment they return to use the commissary system they have earned as indirect pay through their years of faithful service.

In conclusion, DeCA delivers this valuable non-pay compensation to our service members in a cost-efficient and effective manner. The cost-saving initiatives have far exceeded the benefits envisioned by the Jones Commission and DMRD 972. Nevertheless, DeCA is dedicated to providing its patrons the quality and valued service they deserve in the most efficient manner within the fiscal and staffing realities of a re-engineered government. Using 1993, the high point of appropriated funding for the commissary, as the baseline, by the end of fiscal year 1997,¹ DeCA will have reduced its operating costs by more than 25 percent; implemented savings initiatives of \$385 million; reduced its workyears by over 15 percent; and reduced above store level staffing overhead by 40 percent. These impressive accomplishments demonstrate DeCA's commitment to provide the highest quality service at the lowest cost to taxpayers.

¹Expressed in FY92 constant dollars and decremented in budget.

Mr. MCHUGH. Thank you, General Beale. Moving down to your left, our next witness will be General Swarts. Welcome, sir.

STATEMENT OF MAJ. GEN. ROBERT F. SWARTS, U.S. AIR FORCE, COMMANDER, ARMY-AIR FORCE EXCHANGE SERVICE (AAFES)

General SWARTS. Thank you, Mr. Chairman. It is a pleasure, once again, to appear before the Panel as a representative of the 62,000 associates of the Army and Air Force Exchange Service.

This July marks the 100th anniversary of the exchange system which was established by the War Department in 1895, with a two-fold mission; to provide merchandise of necessity and convenience to the soldiers and to return a reasonable profit on the sales which was to be used to support morale, welfare, and recreation activities on the post.

I am proud to say that our mission has not significantly changed in these 100 years. We have modernized it to include some new areas of services. We have added a few new terms. Essentially, the mission has stood the test of time; a test of the fundamentals of support to soldiers' and airmen's quality of life.

The merchandise and services provided to support our military patrons are made available through nearly 12,000 activities at about 450 locations worldwide.

We have 17 business areas that we operate to include our main stores, our specialty stores, personal services activities—such as barber shops and beauty shops—food activities, and literally thousands of vending and concession activities. We operate food plants and bakeries overseas.

In addition to our normal retail function, we will provide nearly 4.7 million school lunches during this next school year. Like my peers in the other services, we provide our support to only authorized patrons.

It is important to note that this customer base is shrinking. As we draw down our military, this presents a challenge to us; how to maintain the required levels of exchange support, return that reasonable profit for MWR, and, at the same time, draw down our operations to reflect these lower sales.

This is the challenge that we face today. As a backdrop to our operating results in 1994, our customer base was of active, guard, and reserve. Retired and their families were down 11 percent since 1992, with the active component down nearly 17 percent. In Europe over these same two periods, the active duty component was down 27 percent.

Unlike our competitors outside the gate who attract each other's customers, we can only retain or recapture those that are authorized to use our facilities; a tough task when you realize that many of our customers do not reside on the installation and must past those competitors to shop with us.

In 1994, we enjoyed sales of \$7.1 billion, down 8 percent from our record sales of \$7.7 billion in 1993, but only down 3 percent since 1992. That's not bad considering that 11-percent decline in customer base.

Likewise in earnings, our earnings of \$69 million were down about 9 percent since 1992. This is not what we had planned, but

it is not bad considering the decline in our customer base, especially in Europe where our operating results were some \$50 million above what we had planned and what we had expected to see in the years prior.

Of this \$289 billion, we paid out \$184 million in dividends to the Army, the Air Force, the Marine Corps where we operate the stores on Okinawa, and also to the Navy where we operate on the Naval Air Station Fort Worth Joint Reserve Base. This is some 69 percent of our earnings.

Said another way, in the case of the Army and the Air Force, nearly 50 percent of every MWR dollar spent came from the exchange dividend. We accomplished this with about \$140 million direct taxpayer support. That was mainly CONUS transportation, utility, and facility support.

I have included in my formal statement our many other 1994 accomplishments, and our plans for 1995. I will be happy to answer questions on our operations and about the terrific job the men and women of AAFES do to enhance the quality of life of our military families. Thank you, sir.

RECORD VERSION

STATEMENT BY

MAJOR GENERAL ROBERT F. SWARTS, USAF

COMMANDER, ARMY AND AIR FORCE EXCHANGE SERVICE

BEFORE THE

MORALE, WELFARE AND RECREATION PANEL

COMMITTEE ON NATIONAL SECURITY

UNITED STATES HOUSE OF REPRESENTATIVES

FIRST SESSION, 104TH CONGRESS

EFFECT OF FORCE STRUCTURE DRAWDOWNS ON
COMMISSARIES AND EXCHANGES

6 APRIL 1995

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NATIONAL SECURITY
COMMITTEE

Mr. Chairman and Members of the Committee :

I am Major General Robert F. Swarts, Commander of the Army and Air Force Exchange Service, and it is my great pleasure to appear before the Committee to bring you up to date on the Army and Air Force Exchange Service and the support we provide to the men and women of our Armed Services and their families.

BACKGROUND OF AAFES

The AAFES mission remains unchanged after a century of service. As commissioned by the Secretary of War in 1895, we provide quality merchandise and services at uniformly low prices to soldiers and airmen stationed around the world; and, generate revenues to augment the Services' Morale, Welfare and Recreation (MWR) programs.

Quality of life programs are vital to retention and to the readiness of today's force. AAFES contributes significantly to the

quality of life of the service member. We exist to support active duty, National Guard, Reserve and retired military and their families in the U.S. and around the globe. Our VISION is:

"To be Our Customers' First Choice by Providing High Quality Goods and Services at Low Prices and at the Lowest Cost."

To our nation's all-volunteer force, the exchange benefit is a major form of non-pay compensation. AAFES provides the goods and services needed by service members and their families. Items ranging from toothpaste to lawn mowers to clothing; from diapers to auto parts; from basic military uniform articles to what has become a basic household item -- a color television set -- all are important in the AAFES stock assortment.

AAFES also provides services not immediately thought of when thinking of the PX or BX. We operate bakeries, dairy and ice cream plants in overseas locations to provide our customers the quality of life and standards they enjoy in the U.S. We bake and package

merchandise not only for resale, but also for issue to commissaries, dining halls, hospitals, and clubs. In support of DoD's schools, we will provide 4.7 million school lunches around the world this school year. We also provide free motion picture entertainment for our troops stationed in remote areas.

AAFES 1994 IN REVIEW

We have accomplished our mission in 1994 against the backdrop of continued force reductions and base closures. Over the past two years our customer base has dropped approximately 11 percent. This demographic decline actually eased in 1994 - down 1.4 percent compared to the 9.5 percent drop in 1993. The overall customer demographics of course include the national guard, reserves, retirees and their dependents - some of which do not live near installations where our stores are located.

Active duty customers (and their dependents) declined five percent in 1994 and over 12 percent in 1993. That is a drop of 17

percent since 1993 and poses a significant challenge to AAFES. In Europe over this same period, customer count was down nearly 27 percent. In 1993, we reported record sales of over \$7.7 billion, in large part due to implementing our in-house credit program the Deferred Payment Plan. With DPP becoming a mature program in 1994, we now see those 1993 results were an extraordinary spike on the normally declining trendline resulting from the drawdown. Our 1994 sales of \$7.1 billion were eight percent off of that 1993 high and three percent down from 1992.

AAFES earnings have followed the same pattern. Looking at 1993's \$315 million "high" as an exception, the \$269 million posted for 1994 was 11 percent below the \$301 million we made in 1992. While these results were not what we had hoped for, the decrease was in line with the decline in our overall customer base and expenses which must occur during a drawdown such as markdowns and closure expenses. The latter area is especially true for the European area.

The Army and Air Force use a portion of these earnings to supplement appropriations in support of their MWR programs.

Dividends to the services for 1994 totalled \$183.7 million or 68 percent of earnings. This works out to \$190 per Soldier and Airman - a decline of four percent from our per capita contribution in the boom year of 1993, but actually an increase of three percent compared to 1992.

AAFES will use the remaining earnings to finance all AAFES capital expenditures ranging from new and refurbished facilities to information systems to trucks, trailers and materiel handling equipment. All items that are important for a viable retail business.

CREDIT PROGRAM UPDATE

I touched earlier on the Deferred Payment Plan and how it affected our operating results over the last two years. DPP has been available to our customers stationed overseas since the late 70's and was expanded to the CONUS in 1993. Of course we saw a substantial increase in the accounts receivable carried by AAFES. That balance grew from \$175 million in January 1993 to \$1.0 billion

by the end of 1993. Since then the growth has slowed with the balance now reaching \$1.4 billion.

AAFES has financed the receivable through internally generated funds and short term borrowing. An agreement with a number of major banks provides access to committed funds to meet AAFES needs. AAFES is able to borrow at very advantageous interest rates due to our "best possible" credit ratings from the two main rating services - Moody's and Standard and Poor.

The Committee Report on the Fiscal Year 1995 Defense Authorization Act directed the department to report on the military exchange credit programs, their impact on the exchange services financial condition, and the actions taken to ensure service members were not overextended. The CPA firm of Price Waterhouse & Co. evaluated the credit programs for DoD and we were pleased with the high marks given AAFES DPP.

Price Waterhouse reported that DPP was well founded,

compared favorably with its retail competition and that it positively contributed earnings and dividends to MWR. Also, they said that AAFES balance sheet compared favorably with other financially strong retailers with credit operations, and, was not overly leveraged. Finally, Price Waterhouse indicated that substantial actions had been taken by AAFES to avoid service member overextension of credit.

In March 1994 AAFES implemented \$500 "starter" credit limits for junior enlisted members. For these new credit applicants, a credit check is done promptly and a higher limit may be offered if warranted. Where it is not, usually due to no credit history, the \$500 limit remains in effect for six months. The account is then reevaluated based on the service member's ability to manage credit.

AAFES pro-actively implemented the starter credit limits to reduce the risk of service member overextension to a minimum. We continue to recognize that the service member usually does have alternative credit sources available - sources which do not offer the low cost and greater benefits available through AAFES DPP.

CARSWELL "BXmart" TEST

I would next like to update you on the BXmart test and will start with some background. The Defense Authorization Act of 1992 directed DoD to test for one year, an exchange operating a commissary at no cost to the taxpayer. The Defense Department selected Carswell AFB for the test which started on July 14, 1993. The "test" was to determine if exchange and commissary support can be saved at bases targeted for closure and conversion to a reserve mission, and which also have a significant retiree population.

The alternative in those instances is to eliminate commissary service (and probably the exchange as well). The BXmart sells items for human consumption at commissary pricing (cost plus five percent), and relies on AAFES prices for sufficient margin on the remaining items to cover operating costs. Another way to state the "test" is to see if we can provide service and avoid a loss with a large segment of the stock assortment providing little return on the

inventory investment.

We believed the concept would be viable only if the customer continues to save money through low prices, the local community supports the concept, and the exchanges dividend support to MWR is not threatened.

The department has reported to you on the success of the test after its first year of operation. A full AAFES retail year has just ended also, and I can report that the operations success has continued. Almost \$43 million in BXmart sales in AAFES fiscal year 1994 generated enough margin for the BXmart to virtually break even on a fully burdened basis. However, the key to success is not just the stand-alone BXmart but rather the overall resale operations.

By keeping the commissary type activity open, we also retained the exchange customer traffic and the overall exchange and commissary operations were able to generate a small profit at the Ft. Worth, TX location. On the customer side, what we have heard about

are our good prices, merchandise selection, and most importantly our patrons' sincere appreciation that the commissary is still open.

DoD has approved additional test sites for the BXmart concept. We will open at Homestead AFB this spring and AAFES is working with the department as closure decisions are made and candidates for BXmarts are considered. We will do what we can to retain higher quality of life facilities as the drawdown continues.

I must quickly add that the BXmart concept is not a viable replacement for the commissary! The increased costs to the customers erode the benefit and the reduced profit in the BX may impact the overall MWR dividend. Moreover, the Carswell test is a single data point in an excellent market of reserve, Guardsmen and retirees.

BOOKMARK

The Defense Authorization Act for Fiscal Year 1994 directed the transfer of operations of the Stars and Stripes Bookstores to the exchange services. AAFES assumed management of bookstore operations effective 1 October 1994 under the trade name BookMark. The transition went very smoothly. For AAFES 1995, we project BookMark sales at \$34 million and another \$10 million in periodical sales at other exchange outlets.

Our overseas customers receive a 10 percent savings off of cover prices for all books and magazines. Hardback best sellers are an exception where the savings are 25 percent. Also, we are expanding selection and availability. We offer 1,300 magazine titles, 4,500 hardbacks and 1,000 paperbacks. Through a computer supported special order program, over 260,000 titles will be available for special order.

FORT HOOD DENTAL CLINIC

The new AAFES Dental Clinic at Ft. Hood, Texas, is a particularly "good news" story I would like to tell you about. When the

commander at Ft. Hood told us about the difficulties dependents were have getting timely dental care outside the gate - even at some distance outside - AAFES went to work, and I can now tell you the new AAFES contracted clinic is a resounding success. Currently there are four dentists, three hygienists, and 11 dental assistants there taking care of over 2,300 patients. Our contractor is very professional and has satisfied both the customers, AAFES and the installation.

COOPERATIVE EFFORTS

Last year the department reported to you on a number of areas of ongoing cooperation among the exchange services. These included some significant efforts, then just in the discussion phase, such as the potential joint operation of distribution activities on Guam to support the Navy and AAFES exchanges. Since then, we have agreed in principle that AAFES operations on Andersen AFB, Guam will be supported to the maximum extent possible by NEXCOM's Guam distribution activity or by their new distribution center in Chino,

California. Detailed reviews of items are going on now to align stock assortments and estimate volumes.

I am also very pleased to report that a major new cooperative direction was opened last year between AAFES, Army Community and Family Support Center (CFSC) and Air Force Services Directorate. Collectively we placed the initiatives under the title "Partnering." The initiatives are based on both the similarities in our areas of responsibility and on the natural co-location of AAFES activities on the same installations as MWR's.

Our Partnering initiatives range from the testing of MWR providing amusement machine service to AAFES activities at two major installations, to serious reviews of AAFES providing outsource NAF payroll services to Air Force MWR. These are just a couple of the number of initiatives targeted as potential quick return items at a kick-off meeting held in Dallas late last year.

Our cooperative efforts include several important opportunities

pursued with DeCA. Of course the jointly operated Commissary/Exchange or CX in Stuttgart Germany is no doubt the best known. This format fills a niche where an available adequate facility exists. It provides one stop shopping exchange and commissary service where the demographics would not otherwise support stand-alone facilities.

The CX, however, is only one of several initiatives with DeCA. Others range from AAFES providing merchandise for commissary sales at Geibelstadt, Germany, to DeCA providing AAFES a hundred food items for sale at commissary prices at Ashaffenberg. Finally, the new CONUS effort with commissaries selling AAFES procured magazines at AAFES prices provides a new convenience to our customer. We are also testing an expanded convenience store (shoppette) concept to provide a small number of core food items at locations where the commissary has closed but a commissary is located nearby.

FORCE REDUCTION - COMPETITIVE IMPACT

Not only have the force reductions, BRAC and the shift to a CONUS- based force shrunk AAFES customer base as never before - there are market changes that pose challenges to AAFES. These challenges, and the evolution in today's retail market place, act together to place AAFES at a competitive disadvantage.

If the MWR dividends are to continue at the current levels, the active duty and overseas customers must be replaced by national guardsmen, reservists and retirees who often live many miles from exchange stores. Frequently they live closer to large discount stores and wholesale clubs which can devote more square footage to broad stock assortments in bidding for our customers' patronage. It is in this environment today that AAFES ability to compete on an even keel is hampered by our stock assortment restrictions.

In today's retail environment, the ability to offer the broadest possible merchandise selection is key to getting the customer to the store - the

starting point in addressing his retail needs. The times have changed from the day when the small independent retailer saw a need to be protected from the exchanges. Today, the cost price limitations and country of origin restrictions are limiting AAFES ability to compete with the discounters and to meet our customers needs - reducing AAFES revenue, earnings and dividends to MWR accordingly. AAFES is working with the department to develop changes to the Armed Services Exchange Regulation to eliminate these restrictions.

APPROPRIATED FUNDS

We often speak of AAFES as "virtually self supported" by our revenues, but, it is important to recognize the vital role a relatively small level of appropriations plays in achieving our mission. Equal to only two cents on each customer's dollar, 90 percent of these appropriations is specifically targeted to support the Soldier and Airman stationed overseas. The vast majority is for what we refer to as Second Destination Transportation. That is, the shipping of merchandise from a U.S. port of debarkation to the first landfall overseas.

Without SDT support, the Soldier and Airman would ultimately pay the price for having U.S. products to buy in our exchanges overseas. The alternatives are to offer foreign merchandise overseas, raise prices on U.S. merchandise shipped overseas, raise prices on all merchandise across the board to cover the extra overseas shipping costs or cover the costs with reduced dividends to the MWR funds (i.e., to the Soldier and Airman). All of these alternatives put in perspective the important benefit SDT funding provides to our service members on duty today where their government needs them.

We have provided DoD with the best projections we can make at this time for our out-bound needs for Appropriated Funds. AAFES itself is not the actual budgeting agency for these appropriations. We are supported by the Army as executive agent for our SDT and the other appropriation requests are on a number of budget lines of both the Army and Air Force. In total, our request for FY 96 is \$153 million exclusive of military pay. This committee has been a strong supporter in the past in assuring the funding is available to meet the Soldier and Airman's needs and we look forward to your continued support.

AAFES GOALS FOR 1995

AAFES projections for 1995 are based on continued drawdown of the force with some offset in terms of an increasing retired customer base. Active duty and dependent reductions affecting AAFES are just under six percent worldwide and guard/reserve reductions are projected at four percent. We expect sales will decline three percent to \$6.9 billion. Earnings will increase eight percent to \$291 million and MWR payments to the Army, Air Force and USMC will be \$188 million. On a per capita basis, the projected dividend of \$202 per service member compares favorably even with the extraordinary \$198 paid in 1993 as well as the \$190 posted for 1994.

We have set several additional goals for ourselves to focus on in 1995. First and most important is to retain our existing customers patronage and to attract prior and new customers into our stores. We will continue to survey our customers and to track survey results in order to focus our

merchandise and services on customer needs.

In order to meet our first goal, we must implement the new technologies needed to provide AAFES the competitive advantage needed to become our customers' first choice. These efforts will be in line with the direction set through the DoD Executive Resale Board to achieve information systems with the maximum opportunity for cooperation between AAFES, our sister exchange services and DeCA.

We have to maintain an effective work force into the future. Consequently our third goal is to be a desired employer, affording our people job satisfaction and opportunities for personal and professional growth at a fair level of compensation and benefits. We will implement career path planning to align jobs with the skills needed to do them and with the lessons that should be learned for advancement.

Through the DoD Executive Resale Board (including the other exchange services, DeCA, and each services lead MWR agency) an ongoing goal is to engage in cooperative efforts within the resale

community wherever they make sense. These efforts will build on the success we have enjoyed, as discussed earlier, working together to provide better, more cost effective service.

Finally, AAFES has to continue to maximize sales AND reduce operating costs. We are setting specific targets for each business to include sales and earnings objectives. Other targets are set to hold the line on expenses and to reduce overhead. As such, we will be reducing the size of our employee base, both in the store and at HQ, a necessity to remain viable for the future. Every effort is being made to use the tools available to the maximum extent to ease the pain of those reductions on the individual members of our work force.

Our efforts at re-engineering processes and improving our organization are also continuing. In 1995 we will look at our overseas organization with a view towards further streamlining and cost reduction. Through these ongoing strategies to deal with the challenges of force structure reductions, base closures and the evolving retail marketplace, AAFES will be in a position to meet its

mission in the future as it has for the last 100 years.

CONCLUDING REMARKS

Mr. Chairman, I appreciate the opportunity to talk to the panel once again about AAFES. As we prepare to celebrate our centennial, it is a story of our employee's dedication and efforts to support the soldier, airman, marine and sailor and their loved ones. I am proud to serve as the AAFES Commander as we prepare for AAFES future.

On behalf of soldiers and airmen serving around the world, and the 63,000 AAFES associates, I thank you and the Committee on National Security for the strong support you have given them. I look forward to your continued support. I will be happy to answer your questions.

Mr. McHUGH. Thank you, General Swarts. We appreciate your testimony.

Next, we would like to hear from Admiral Kavanaugh.

STATEMENT OF REAR ADM. JOHN T. KAVANAUGH, COMMANDER, NAVY EXCHANGE SERVICE COMMAND (NEXCOM)

Admiral KAVANAUGH. Thank you, Mr. Chairman. Good morning, it is a pleasure to be here. I would like to submit my formal statement for the record, and just make a few points that have come up in the last week.

I note that we had a great 1994 in the Navy Exchange System. Despite the 14-percent reduction we have had since 1992 in active duty personnel in the Navy, our sales are only off 2.5 percent. Our profits are off 3 to 4 percent, depending upon our recouping of all of the BRAC closure costs that we have incurred.

As General Swarts said for both AAFES and us, 1993 was a record year because of the initiation of our Automated Deferred Payment Program NEX Card. The last time we met, you tasked OSD to conduct an independent analysis of our NEX Card Program.

OSD hired Price Waterhouse to do the study. In their report back to OSD, Price Waterhouse said, "NEX Card is a well-founded program that compares favorably to its retail competition, and NEXCOM's balance sheet favorably compares to other retailers who are considered financially strong and have private label credit operations."

Last November, at the same time of the 1-year anniversary of the NEX Card Program, I asked CitiCorp Corp., CRS, who is our contractor that runs it, how we could improve the program. What had we been doing wrong for a year? They are the experts. They came back and made a number of recommendations to us that would further strengthen the program, primarily by instituting credit checks on new applicants and assign starter credit limits to those applicants with no credit history.

They are in the process of making the necessary ADP changes to do this now. Speaking of automatic data process changes, our systems modernization effort that you approved about a year and a half ago is well underway.

Hardware and software have been purchased; all off-the-shelf retail systems that are currently used in the commercial sector today. The Alpha test will be run this summer at Naval Air Station Oceana.

This modernization effort is the key to becoming more competitive in this already highly competitive retail world; enabling us to better meet our two-fold mission—to provide to our customers, quality goods and services at a savings, and to support quality of life programs.

We are self-sufficient through the generation of NAF revenues, nonappropriated funds. I think this is an area that may cause some confusion, especially in our area of pricing.

Last week, "Stars and Stripes" ran an article on the MWR hearings that alleged the Navy Exchange system had higher prices than the other systems; or why don't we mark up everything just 5 percent like the commissary?

This is the same issue whenever I speak to senior Navy leadership, Navy ombudsmen, command master chiefs, or the junior enlisted personnel. I always get the same question. Why is milk \$1 in the commissary and \$1.25 in the Navy Exchange Mini-Mart?

The answer is that all 21,000 Navy Exchange associates are paid from revenues generated from the \$2.1 billion in sales we had. I pay all of their salaries. I pay all utilities, all depreciation off the buildings we construct with those funds, all health benefits, retirement benefits, worker's compensation, all out of sales revenues.

There are no taxpayer dollars. Very minimum taxpayer dollars support exchange cost of operations as General Beale indicated they do in the commissary. The commissary supports the salaries of all of the managers, the checker, and the contractors that stock the shelves. We pay our people to do that.

In addition to paying our own cost of operation, we also return our profits, called dividends, back to the base commanding officers to support their morale, welfare, and recreation programs. The Navy Exchange is a family run business. Forty percent of our associates are Navy family members.

All of our profits are returned to improve the welfare of our sailors and their families. This morning, 46 percent of our ships were at sea; 25 percent on 6-month extended deployments.

Sailors want to know their families are being taken care of. That they have a commissary, a Navy Exchange, a Family Service Center, a chaplain, and MWR activities on their base so their families are well taken care of when they are gone. This is a Navy family.

Navy families go through a lot, and Navy personnel go through a lot. It is my job to make sure that they are taken care of the very best that I can. With your help, we will keep on working hard and, hopefully, get better every day. Thank you, Mr. Chairman.

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THE COMMITTEE ON NATIONAL SECURITY
UNITED STATES HOUSE OF REPRESENTATIVES

STATEMENT OF
REAR ADMIRAL JOHN T. KAVANAUGH, SC, USN
COMMANDER, NAVY EXCHANGE SERVICE COMMAND
BEFORE THE MORALE, WELFARE AND RECREATION PANEL
OF THE
COMMITTEE ON NATIONAL SECURITY
UNITED STATES HOUSE OF REPRESENTATIVES
ON THE EFFECT OF
FORCE STRUCTURE DRAWDOWNS
ON
COMMISSARIES AND EXCHANGES
APRIL 6, 1995

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UNITED STATES HOUSE OF REPRESENTATIVES

MR. CHAIRMAN AND DISTINGUISHED MEMBERS OF THE HOUSE NATIONAL SECURITY COMMITTEE MORALE, WELFARE AND RECREATION (MWR) PANEL. I AM REAR ADMIRAL JACK KAVANAUGH, COMMANDER OF THE NAVY EXCHANGE SERVICE COMMAND (NEXCOM). I AM EXTREMELY PLEASED TO REPRESENT THE NAVY EXCHANGE SYSTEM AND ITS 21,000 DEDICATED ASSOCIATES TO PROVIDE YOU AN OVERVIEW OF THE QUALITY OF LIFE ENHANCEMENTS WE PROVIDE TO OUR MILITARY MEN AND WOMEN, RESERVISTS, RETIREES, AND THEIR FAMILIES.

QUALITY OF LIFE IS ESSENTIAL TO READINESS, AND OUR PROGRAMS DIRECTLY SUPPORT THE QUALITY OF LIFE OF OUR NAVY FAMILIES AROUND THE WORLD. THE PANEL'S PAST SUPPORT IS APPRECIATED, AND YOUR FUTURE SUPPORT SHOULD ENABLE US TO SUPPORT OUR NAVY MEMBERS WHEREVER THEY ARE STATIONED AROUND THE WORLD.

AS THE COMMANDER OF NEXCOM, I REPORT DIRECTLY TO REAR ADMIRAL BOB MOORE, COMMANDER, NAVAL SUPPLY SYSTEMS COMMAND, AND I RECEIVE PROGRAM GUIDANCE AND OVERSIGHT WITHIN THE NAVY DEPARTMENT FROM A BOARD OF DIRECTORS OF SENIOR FLAG OFFICERS AND THE MASTER CHIEF PETTY OFFICER OF THE NAVY. WE COORDINATE OVERALL POLICY AND PROCEDURES WITH THE OFFICES OF THE

SECRETARY OF THE NAVY AND THE SECRETARY OF DEFENSE. WE PARTICIPATE IN NUMEROUS COOPERATIVE VENTURES WITH THE OTHER EXCHANGE SERVICES TO IMPROVE EFFICIENCY AND EFFECTIVENESS, THROUGH THE DOD EXECUTIVE RESALE BOARD UNDER MR. PANG.

THE NAVY EXCHANGE SYSTEM WAS OFFICIALLY ESTABLISHED IN APRIL 1946 WITH THE OBJECTIVE OF IMPROVING THE QUALITY OF LIFE OF NAVY PERSONNEL, AND TO PROVIDE NON-PAY COMPENSATION AS PART OF A TOTAL BENEFIT/COMPENSATION PACKAGE. THE MISSION HAS CHANGED VERY LITTLE SINCE 1946. OUR MISSION TODAY, AS STATED IN OUR STRATEGIC PLAN, IS: "TO PROVIDE OUR CUSTOMERS QUALITY GOODS AND SERVICES AT A SAVINGS, AND TO SUPPORT QUALITY OF LIFE PROGRAMS." WE ARE SELF SUFFICIENT THROUGH THE GENERATION OF NONAPPROPRIATED FUND REVENUES FROM OUR BUSINESS OPERATIONS. WE DO RECEIVE A RELATIVELY SMALL AMOUNT OF APPROPRIATED FUNDS FOR MILITARY COMMAND AND CONTROL FUNCTIONS, MILITARY PERSONNEL, OVERSEAS MOVEMENT OF MERCHANDISE AND REIMBURSEMENT OF AUTHORIZED BASE REALIGNMENT AND CLOSURE COSTS. NOW, AS IN 1946, ALL OUR EFFORTS ARE FOCUSED ON PROVIDING QUALITY MERCHANDISE AND SERVICES AT A SAVINGS TO THE WORLD-WIDE NAVY COMMUNITY. THE FOUR PROGRAMS THAT TODAY COMPRISE THE NAVY EXCHANGE SYSTEM ARE THE NAVY EXCHANGE

PROGRAM; THE SHIPS STORE PROGRAM; THE NAVY UNIFORM PROGRAM; AND, THE NAVY LODGE PROGRAM. EACH PROGRAM IS DESIGNED TO ENHANCE QUALITY OF LIFE BY FULFILLING BASIC NEEDS OF EVERY MEMBER OF OUR NAVY FAMILY, REGARDLESS OF THEIR ASSIGNED LOCATION - AN IMPORTANT ASPECT OF OUR MISSION IN THAT 30% OF OUR SALES AND SUPPORT OCCUR IN OUR OVERSEAS LOCATIONS.

NAVY EXCHANGE STORES COMPRISE THE LARGEST AND MOST DYNAMIC OF THE FOUR NAVY EXCHANGE SYSTEM PROGRAMS. EACH OF THE 133 RETAIL COMPLEXES PROVIDE AUTHORIZED PATRONS QUALITY GOODS AND SERVICES AT A SAVINGS. EACH EXCHANGE IS AN INTEGRAL PART OF THE QUALITY OF LIFE PARTNERSHIP UNDER THE DIRECTION OF THE COMMANDING OFFICER AT THE LOCAL BASE OR STATION. THE NAVY EXCHANGE OFFICER IS A KEY MEMBER OF THE COMMANDING OFFICER'S STAFF, AND IS RESPONSIBLE FOR LOCAL EXCHANGE OPERATIONS AND PROFITABILITY. OUR EXCHANGES SERVE AS A HIGH VOLUME DISCOUNT STORE SUPPLYING BASIC NEEDS FOR OUR YOUNG ENLISTED MEMBERS AT A PRICE THEY CAN AFFORD, AND AS A MIDSCALE DEPARTMENT STORE TO OUR MORE SENIOR MEMBERS AND RETIREES. IN ADDITION TO PROVIDING NAVY MEMBERS A VALUABLE NON-PAY COMPENSATION IN THE FORM OF EXCELLENT VALUE AT CONSISTENTLY LOWER PRICES, THE EXCHANGES PROVIDED 70 MILLION DOLLARS OF NONAPPROPRIATED

FUND REVENUES TO NAVY MORALE, WELFARE AND RECREATION PROGRAMS AIMED AT IMPROVING THE QUALITY OF LIFE AND ENHANCING THE READINESS OF OUR NAVY PERSONNEL AND THEIR FAMILIES.

1994 WAS A VERY GOOD YEAR FOR THE NAVY EXCHANGE PROGRAM. WE HAD A SLIGHT INCREASE IN SALES FROM 1992 DESPITE AN 18% REDUCTION IN ACTIVE DUTY PERSONNEL SINCE 1992. OUR 1994 SALES, AS ANTICIPATED, WERE SLIGHTLY LESS THAN IN 1993 WHICH WAS THE MOST SUCCESSFUL YEAR IN OUR 48-YEAR HISTORY. WE ARE EXTREMELY PLEASED WITH THESE RESULTS AND OUR OVERALL FINANCIAL HEALTH. YOU RECENTLY REQUESTED AN INDEPENDENT CPA ANALYSIS OF OUR FINANCIAL CONDITION IN RELATION TO OUR EXTENSION OF CREDIT TO OUR CUSTOMERS AND THE FAVORABLE LINE OF CREDIT EXTENDED TO US BY A CONSORTIUM OF COMMERCIAL BANKS. THAT INDEPENDENT ANALYSIS CONFIRMED WHAT THE CONSORTIUM OF BANKERS ALREADY KNEW; SPECIFICALLY, THAT WE ARE INDEED VERY SOUND FINANCIALLY - THAT WE ARE IN EXCELLENT FINANCIAL CONDITION.

THE NAVY UNIFORM PROGRAM PROVIDES THE SOLE SOURCE OF AUTHORIZED UNIFORMS TO ALL NAVY PERSONNEL , BOTH ACTIVE DUTY AND RESERVES. UNIFORMS MAY BE OBTAINED FROM ANY ONE OF THE 118 NAVY EXCHANGE UNIFORM CENTERS. ADDITIONALLY, THROUGH ONE OF MANY COOPERATIVE WORKING ARRANGEMENTS WITH THE OTHER

MILITARY EXCHANGE SERVICES, WE ARE PROVIDING UNIFORM SUPPORT TO THE OTHER SERVICES AT SOME LOCATIONS. IN FACT, THROUGH OUR TOLL-FREE MAIL ORDER UNIFORM PROGRAM, NAVY AND MARINE CORPS UNIFORMS ARE CONVENIENTLY AVAILABLE TO ACTIVE DUTY OR RESERVE PERSONNEL WHEREVER THEY ARE STATIONED OR LIVE AROUND THE WORLD.

THE NAVY LODGE PROGRAM PROVIDES TEMPORARY HOUSING TO OUR SAILORS AND THEIR FAMILIES WHILE ON PERMANENT CHANGE OF STATION ORDERS OR TEMPORARY DUTY AT AN AVERAGE SAVINGS OF 20% WHEN COMPARED TO LOCAL COMPARABLE ACCOMMODATIONS. WE PRESENTLY PROVIDE 2,451 CLEAN, COMFORTABLE ROOMS AT 42 LOCATIONS AROUND THE WORLD. OUR GUESTS CAN MAKE RESERVATIONS WORLDWIDE THROUGH OUR TOLL-FREE RESERVATION SYSTEM. NEW GUEST ROOMS ARE CONTINUALLY BEING ADDED TO THE INVENTORY. WE RECENTLY OPENED NEW LODGES OR CONSTRUCTED NEW ROOMS IN ATSUGI, JAPAN; BETHESDA, MD; PENSACOLA, FL; PORT HUENEME, CA; ROTA, SPAIN; AND WHIDBEY ISLAND, WA. WE HAVE RECENTLY RENOVATED ROOMS IN ALAMEDA, CA; BETHESDA, MD; KEFLAVIK, ICELAND; AND PENSACOLA, FL, AND HAVE RENOVATION AND CONSTRUCTION PROJECTS UNDERWAY AT 10 ADDITIONAL LOCATIONS. OUR NAVY LODGE ASSOCIATES ARE CONTINUALLY BEING TRAINED TO

PROVIDE OUR NAVY PATRONS STATE-OF-THE-HOTEL INDUSTRY SERVICE. THE NAVY LODGE PROGRAM IS FUNDED ENTIRELY THROUGH SELF GENERATED REVENUES. NO APPROPRIATED FUNDS SUPPORT THE LODGE PROGRAM.

THE SHIPS STORE PROGRAM SERVES OUR MEN AND WOMEN ABOARD NAVY SHIPS BY PROVIDING A SELECTION OF BASIC MERCHANDISE, CONVENIENCE ITEMS AND GIFT TYPE MERCHANDISE. SHIPS STORES ALSO OPERATE QUALITY OF LIFE SERVICES SUCH AS VENDING MACHINES AND ELECTRONIC GAME MACHINES FOR AMUSEMENT DURING OFF-DUTY HOURS; AND, ONBOARD LAUNDRY/DRY CLEANING AND BARBER SERVICES IN SUPPORT OF BASIC CLEANLINESS AND HYGIENE. SHIPS STORES ARE OPERATED USING APPROPRIATED FUNDS AND GENERATE DIVIDENDS TO SUPPORT SHIPBOARD MWR PROGRAMS THAT ARE SO VITAL TO BUILDING MORALE AND READINESS OF OUR SAILORS AT SEA.

OUR NAVY EXCHANGE SYSTEM IS IN MANY WAYS A FAMILY RUN BUSINESS - A NAVY FAMILY BUSINESS OPERATED BY THE NAVY FAMILY FOR THE BENEFIT OF NAVY FAMILIES. A SIGNIFICANT PERCENTAGE OF OUR ASSOCIATES ARE NAVY FAMILY MEMBERS. MOST OF THE CONCESSIONAIRES WE PARTNERSHIP WITH ALSO EMPLOY MILITARY FAMILY MEMBERS. SOME ALSO PROVIDE PART-TIME EMPLOYMENT TO

SOME OF OUR JUNIOR ENLISTED MEMBERS. THIS FAMILY ASPECT OF OUR BUSINESS RESULTS IN OUR EXCEPTIONAL RESPONSE TO NAVY MEMBERS IN NEED. AS AN EXAMPLE, LAST SPRING, TRAGEDY STRUCK SEVERAL NAVY FAMILIES STATIONED IN ROTA, SPAIN. THEY LOST MOST, IF NOT ALL, OF THEIR HOUSEHOLD POSSESSIONS IN A FIRE. OUR ASSOCIATES EXECUTED AN EXTREMELY SUCCESSFUL PLAN TO HELP THOSE NAVY FAMILIES, PROVIDING CONTRIBUTIONS, LODGING IN THE NORFOLK NAVY LODGE AND SPECIAL SHOPPING TRIPS TO THE EXCHANGE AND OTHER LOCAL NORFOLK STORES TO REPLACE LOST PERSONAL BELONGINGS. THIS IS A TYPE OF SERVICE, A DEGREE OF CARE, THAT COULD ONLY BE PROVIDED BY AN ORGANIZATION IN THE NAVY EXCHANGE SYSTEM'S UNIQUE POSITION OF BEING OWNED AND OPERATED BY THE NAVY FAMILY. WE ALSO SUPPORTED MILITARY PERSONNEL IN THE ADRIATIC REGION WITH THE OPERATION OF A SHIP STORE ASHORE IN ZAGREB, CROATIA. THE TASK WAS CHALLENGING BECAUSE OF ITS REMOTE AND DANGEROUS LOCATION, BUT WE SAW TO IT THAT THE MEN AND WOMEN SERVING IN THAT THEATER WERE PROVIDED WITH NEEDED MERCHANDISE AND SERVICES. THE ENHANCEMENT TO QUALITY OF LIFE IN THESE SITUATIONS, ALTHOUGH UNMEASUREABLE, IS NONE-THE-LESS REAL AND IS A TREMENDOUS SOURCE OF PRIDE FOR ALL OUR ASSOCIATES.

LOOKING TO THE FUTURE, WE HAVE TWO SIGNIFICANT CHALLENGES TO OUR CONTINUED SUCCESS; A DECLINING PATRON BASE AS A RESULT OF THE OVERALL MILITARY DOWNSIZING, AND SUBSTANTIALLY INCREASING COMPETITION WITHIN THE RETAIL INDUSTRY.

IN AN EFFORT TO OFFSET THE POTENTIALLY NEGATIVE IMPACT ON REVENUES GENERATED BY THE REDUCTION TO OUR AUTHORIZED PATRON BASE, WE ARE EXPANDING OUR NAVY EXCHANGE OPERATIONS BY IDENTIFYING NEW AREAS OF BUSINESS. WE ARE AGGRESSIVELY PURSUING A NEW NAVY WIDE CONTRACT TO REPLACE THE EXISTING PAY TELEPHONE CONTRACT AND PROVIDE ALL UNOFFICIAL TELECOMMUNICATION SERVICES. THIS CONTRACT WOULD INCLUDE TELEPHONE AND CABLE TELEVISION CAPABILITY TO BACHELOR QUARTERS, NAVY LODGE ROOMS AND BASE HOUSING; PAY TELEPHONES AT PIERSIDE AND OTHER LOCATIONS THROUGHOUT OUR BASES; AND TELEPHONE DEBIT CARDS. AN AWARD IS EXPECTED TO BE MADE THIS SUMMER. OUR FIRST OPTOMETRY CLINIC OPENED AT NAVAL BASE NORFOLK IN JANUARY OF THIS YEAR AND HAS BEEN EXTREMELY POPULAR. WITH YOUR HELP WE HOPE TO EXPAND THIS AND OTHER HEALTH CARE RELATED SERVICES TO OTHER LOCATIONS IN THE NEAR FUTURE; NOT JUST TO GENERATE REVENUE, BUT TO PROVIDE VALUABLE QUALITY OF LIFE SERVICES AT A SAVINGS TO NAVY FAMILY MEMBERS

WHEN AND WHERE APPROPRIATED FUND ACTIVITIES CANNOT PROVIDE THIS MUCH NEEDED QUALITY OF LIFE CARE. WE ARE CONTINUALLY EXAMINING WAYS TO AUGMENT OUR QUALITY OF LIFE SERVICES BY PROVIDING CONVENIENCE, QUALITY AND VALUE WHILE GENERATING NONAPPROPRIATED FUND REVENUES FOR NAVY MWR PROGRAMS. WE NEED YOUR SUPPORT AS WE PURSUE THESE VERY WORTHWHILE INITIATIVES.

IN RESPONSE TO THE SIGNIFICANTLY INCREASING COMPETITION IN THE RETAIL MARKETPLACE AND TO PRESERVE OUR ABILITY BOTH TO OFFER REDUCED PRICES TO OUR CUSTOMERS AND GENERATE NONAPPROPRIATED FUND REVENUES FOR MWR PROGRAMS, WE ARE FOCUSING SIGNIFICANT EFFORTS ON BETTER WAYS OF PERFORMING OUR KEY BUSINESS FUNCTIONS, I.E., BECOMING MORE EFFICIENT AND EFFECTIVE IN WHAT WE DO. OUR PRIMARY INITIATIVE IN THIS REGARD IS THE MODERNIZATION OF OUR INFORMATION SYSTEMS USING OFF-THE-SHELF TECHNOLOGY AND PROCESS REENGINEERING. OUR ADP MODERNIZATION INITIATIVE IS ANOTHER EXAMPLE OF OUR COOPERATIVE EFFORTS WITH OTHER EXCHANGE SERVICES AS WE HAVE BEEN JOINED IN THIS EFFORT BY THE MARINE CORPS EXCHANGE SERVICE. THIS MODERNIZATION EFFORT IS 18 MONTHS INTO A 48 MONTH SCHEDULE AND IS MOVING ALONG NICELY.

ALSO IN THE AREA OF MAINTAINING COMPETITIVENESS WITH THE COMMERCIAL RETAIL SECTOR, WE HAVE IDENTIFIED SEVERAL REGULATORY AND PROCEDURAL IMPEDIMENTS TO OUR BEING ABLE TO PROVIDE FULLY FOR THE DESIRES OF OUR NAVY CUSTOMERS. THE ARMED SERVICES EXCHANGE REGULATIONS WERE INITIALLY IMPOSED TO PROTECT SMALL LOCAL MERCHANTS FROM PERCEIVED UNFAIR ADVANTAGES THAT MIGHT ACCRUE TO A GOVERNMENT BUSINESS OPERATION. MOST OF THESE SMALL LOCAL STORES HAVE BEEN REPLACED BY NATIONAL CHAIN DISCOUNTERS. THESE REGULATIONS, MAY UNFAIRLY ADVANTAGE NATIONAL CHAIN DISCOUNTERS AND DEPRIVE OUR SAILORS OF THE FULL POTENTIAL NON-PAY BENEFIT OF THEIR NAVY OWNED AND OPERATED EXCHANGE SERVICE. WE SHOULD TO BE ABLE TO PROVIDE SAILORS THE FULL ASSORTMENT OF MERCHANDISE AND SERVICES AVAILABLE OUTSIDE THE GATE - AT A PRICE SAVINGS AND, IF NECESSARY, WITH REASONABLE FINANCING ASSISTANCE. WE DESPERATELY NEED YOUR SUPPORT AND COOPERATION IN MODIFYING THESE IMPEDIMENTS TO NAVY QUALITY OF LIFE.

IN CLOSING, WE NEED TO DEVELOP A SHARED VISION OF THE NAVY EXCHANGE SYSTEM OF TODAY, TOMORROW AND WELL INTO THE FUTURE. OUR NAVY EXCHANGE SYSTEM VISION IS TO CONTINUE TO BE A

PROFESSIONAL, INNOVATIVE AND RESPONSIVE BUSINESS TEAM, WHOSE STRENGTH IS OUR UNIQUE ABILITY TO SERVE THE NAVY AND ITS WORLDWIDE POPULATION IN AN EVER-CHANGING ENVIRONMENT THROUGH A STRONG SYSTEM OF QUALITY OF LIFE PROGRAMS AFLOAT AND ASHORE. WE MUST CONSISTENTLY MEET CUSTOMER EXPECTATIONS BY PROVIDING EXCELLENCE IN QUALITY, PRICE AND SERVICE WHILE GENERATING VALUABLE NONAPPROPRIATED DOLLARS FOR OUR NAVY MWR PROGRAMS. I HOPE YOU SHARE THAT VISION WITH US.

WE APPRECIATE YOUR SUPPORT AS WE WORK TO IMPROVE THE QUALITY OF LIFE OF SAILORS THROUGHOUT THE WORLD, PROVIDING THEM WITH THE QUALITY MERCHANDISE AND PERSONAL SERVICES AT A SAVINGS THEY SO RICHLY DESERVE BECAUSE OF THEIR DEDICATION AND SELFLESSNESS IN SERVING THIS GREAT NATION. I ALSO WANT TO ACKNOWLEDGE THE LOYAL AND DEDICATED SUPPORT WE CONTINUE TO RECEIVE FROM OUR MANY INDUSTRY PARTNERS AND SUPPORTERS. ONLY IN A MUTUALLY SUCCESSFUL PARTNERSHIP CAN WE FULLY SUPPORT OUR NAVY FAMILY AROUND THE WORLD.

THANK YOU FOR THE OPPORTUNITY TO ADDRESS THE MWR PANEL. I WILL BE PLEASED TO RESPOND TO ANY QUESTIONS YOU MAY HAVE.

Mr. McHUGH. Thank you, Admiral.

Last, but not least, we will hear from General Joy.

STATEMENT OF BRIG. GEN. JAMES R. JOY, U.S. MARINE CORPS (RET.), DIRECTOR, MWR SUPPORT ACTIVITY, U.S. MARINE CORPS

General JOY. Good morning, Mr. Chairman and distinguished members of the Panel. It gives me great pleasure to represent the U.S. Marine Corps here today and to tell you a little bit about our exchange system.

I told you a little bit last week about how our MWR organization differed from the other services. I should point out that our exchanges are somewhat different from AAFES and NEXCOM exchanges in that our exchanges are very decentralized.

They are actually operated by the commanding officer at each installation. As opposed to General Swarts and Admiral Kavanaugh, I do not command our exchange system. I am a staff officer on the staff of the Commandant. I provide technical guidance and assistance to the commanders of the various installations.

We operate 16 exchanges, 14 exchanges in the continental United States. We have two outside of CONUS; one in Kaneohe Bay, HI, and another at the Marine Corps Air Station, Iwa Kone, Japan. We closed two exchanges at the start of this business year; not because of business reasons, but because of outside influences.

We closed our exchange in the Panama Canal Zone because military strength is on the decrease there. The CINC was of the opinion, and we agreed, that one exchange system was all we needed in Panama. We closed our exchange which, by the way, we operated for both the Navy and the Marine Corps at the Rodman Naval Station. We turned that exchange over to the Army and Air Force Exchange.

For obvious reasons, in Guantanamo Bay, Cuba, we closed our exchange there. The dependents left last year. There was no requirement in Guantanamo Bay to have two, what we call, main exchanges.

The Navy has a very fine main exchange there. So, we turned over our requirement for an exchange to NEXCOM. They are running what we call a convenient store near the Marine installation at Guantanamo Bay.

I would like to publicly thank both General Swarts and Admiral Kavanaugh for the very fine cooperation in the transfer of those two exchange operations. Not only did they buy our inventory at cost, but they also provided employment for every single employee that sought employment once we closed those operations. We had many loyal employees. We had been in Panama for 65 years, and we had been in Guantanamo Bay for 59 years.

Sir, 1994 was a good year for our exchange system. We had sales of \$584 million; up almost \$37 million; up between 6 and 7 percent from the previous year. We attribute the increase in sales to the deferred payment plan, which we are in partnership with the Army and Air Force Exchange System.

This is a credit program that we implemented last year. It was in existence for about half of the year. It provided very strong sales for us. As a result of those sales, we had profits of \$43 million.

Thirty percent of our profits were put back into the business as far as recapitalization. Seventy percent was turned over to our recreation program.

The outlook for 1995 is not quite as rosy as 1994. We are looking at flat and perhaps slightly down sales. DPP has been fully implemented for about half of the year and over this past holiday season.

Also, in 1995, we are going to see the first impact of BRAC. BRAC is not going to have a major impact on the Marine Corps, but in 1995 we are going to start closing the Marine Corps Air Station at Tustan Helicopter Base, and the Marine Corps Air Station at El Toro are going to start sending some of their units to other bases.

In fact, Admiral Kavanaugh will benefit somewhat because some of our units are moving down to Miramar. They will be shopping in the Navy Exchange in Miramar for a few years. Speaking of BRAC, we do have one concern and that is the fact that it would appear to us that the BRAC account, as far as the Marine Corps is concerned, does not have adequate funds to take care of the requirements we are going to have for MWR facilities as we move to Miramar.

We are going to have to expand some of the facilities and enhance some of the facilities. The operational requirements are going to take the BRAC funds. We are concerned that we are going to have to use NAF funds for those enhancements.

Sir, the last point I would like to make is our capitalization program. We have a very strong capital improvement program. Over the last few years, we have either renovated or newly constructed every exchange that we have, with the exception of Kanehoe Bay, HI.

We have three minor projects that we are going to be building in the next 2 or 3 years. As I said, our exchanges, our physical plant, is in very, very good shape. Sir, with that, I will close. I will be happy to answer any questions that you might have.

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NATIONAL SECURITY COMMITTEE

STATEMENT OF
JAMES R. JOY
DIRECTOR
MORALE, WELFARE AND
RECREATION SUPPORT ACTIVITY
U.S. MARINE CORPS
BEFORE THE
MORALE, WELFARE AND RECREATION PANEL
OF THE
HOUSE NATIONAL SECURITY COMMITTEE
CONCERNING
EXCHANGES AND COMMISSARIES
6 APRIL 1995

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Mr. Chairman and distinguished members of the Morale, Welfare and Recreation Panel. I'm delighted to have this opportunity to again appear before the Panel and bring you up to date on our Marine Corps Exchange program.

The Marine Corps Exchange is the flagship of our MWR delivery system and provides a two-fold benefit to Marines. First, our exchanges are stocked with products and provide services that are desired by Marines and offered at the best price possible. This pricing policy ensures Marines earn at least a 20 percent savings on an average market basket of goods. Secondly, for every dollar spent in the exchange, 6 percent is returned to our Marines in the form of MWR programs and MWR facility construction.

There are 16 exchanges Marine Corps wide. Projected sales figures show our activities generated over \$584.7M in sales in FY94, which represent a \$38.5M increase.

Ensuring our Marines continue to receive a strong two-fold benefit from exchanges is the driving force of our operations. The challenges we face are not new. While force levels in the Corps have leveled off at approximately 174,000, increased operational tempos have affected our customer base. The fierce price competition taking place just outside our gates has not abated, nor will it over the foreseeable future. Our task must

be to position ourselves in such a manner that we can accept and deal with these realities and incorporate common sense and innovative business approaches that will enable us to continue providing for Marines needs.

To maintain our competitiveness and offer the products our young Marines and their families ask for, we need your assistance. Our ability to respond is hampered by stock assortment restrictions. Cost price and size restrictions are limiting our ability to match the national chain discounters. For example, large screen televisions cannot be sold by our stores except overseas, yet most are marketed through CONUS discount chains and large regional retailers. This means our customers go elsewhere. They are not afforded the normal exchange savings, and dividends are not what they could be. This is an area where you could make an immediate positive impact on our Marines, their families and our other authorized patrons' quality of life.

In April 1991, the Office of the Secretary of Defense completed a study of the Department of Defense Exchange system. OSD determined that the size of savings, approximately \$40M/year on \$9B in sales, was not sufficient to offset the advantages to the patrons of competition and local control. Furthermore, there was significant risk in trying to achieve these savings. In lieu of consolidating systems, OSD directed the exchanges develop

cooperative initiatives in specific areas to increase efficiencies, further encourage competition, and standardize certain functions for valid comparisons. We concurred with the OSD position. Subsequently, we undertook cooperative business partnerships with our sister services to improve the services and benefit to Marines. Cooperative partnerships lower our costs, provide greatly increased choices and services, and most important provide increased savings for our customers. For example, in 1992 our exchanges ordered \$1.5M in merchandise from AAFES and NEXCOM. By 1994, the total jumped to \$15M, and we project orders totaling \$60M for 1995. Our MOU with NEXCOM, which provides transportation routing, has resulted in savings of \$137,000 in just over half a year. In FY95 we anticipate increased savings in transportation costs and improved deliveries for our exchanges. We manage the Navy MWR and Marine Corps Nonappropriated Fund Workers' Compensation program. NEXCOM employees are participating in our MWR 401(k) program. Our partnership with AAFES in design and construction of facilities is working well. In FY95, AAFES will design and construct approximately 29 of our projects valued at an estimated \$26.9M. Our participating in the AAFES Deferred Payment Plan has enabled young Marines and Marine families to obtain much needed credit as they establish themselves and their families in our society. These examples illustrate the win-win nature of such cooperative initiatives, and show why we are so deeply committed to pursuing additional opportunities in the future.

Improving the efficiency of our operations requires adjustment to systems that are invisible to the patron, yet are essential for modern retailers. For the past few months, our exchange at MCAS Cherry Point has been the test bed for our new retail Electronic Point of Sale System. Both our customers and exchange personnel are delighted at the convenience and information management it has brought. Following our testing period, we roll it out Marine Corps wide at retail activities. Just last December, we entered into an MOU with NEXCOM to participate in the development of their retail merchandise and accounting solution. Partnering with NEXCOM provides a real savings for us, and the new systems will greatly enhance the efficiency of our operations.

On a positive note, most of our 16 exchange facilities are in excellent condition having been renovated or built in the last five years. Our one remaining exchange construction project is at Kaneohe Bay, Hawaii, and is scheduled for construction in late FY95. When completed, this will give our exchange system what we believe to be a quality physical plant which will meet the needs of Marines today and into the future.

While still on the subject of construction, I would like to briefly speak to the effects of the Base Realignment and Closure Commission (BRAC) on Marine Corps MWR. Marine Corps Air Station El Toro is slated for closure, and many of the Marines now

stationed there will move to Miramar and other installations. Over the years, MWR and exchanges have heavily invested what we term "Marines' Dollars", nonappropriated funds, into construction at bases not slated for closure. It would be a grave injustice if Marines were forced to pay again to construct like facilities at installations where they are relocating for the sake of saving taxpayer dollars. We ask Congress to continue to consider these factors and ensure sufficient appropriated funds so that new or renovated facilities are available at Miramar which are equal to those left behind at El Toro/Tustin.

Improving the quality of life of Marines begins with a firm understanding of their needs and preferences. We can never forget that our prime mission requirement is customer service. In addition to the ground-breaking Marine Corps Quality of Life Research project, we have intensified our market research efforts during the past two years. We are using that data to stock our exchanges, adjust hours of operation, and establish pricing strategies. We have learned that we have three customer groups, single, married without children, and married with children and must individually address their needs. Marines' needs also differ from command to command and we must attune ourselves to demographic, environmental, and geographical requirements.

In conclusion, Mr. Chairman, I strongly believe that by pursuing the initiatives I've outlined to you today, by paying

close attention to our customers, and by developing strong relationships with them and our suppliers, we will be well positioned to manage our Marine Corps Exchanges.

Thank you again for this opportunity to tell the story of our Marine Corps Exchanges. We appreciate and acknowledge the support and guidance of the MWR Panel, and your many contributions to our mission accomplishment. I would be pleased to answer any questions.

Mr. MCHUGH. Thank you very much, General Joy. Thank you to the entire panel. Secretary Pang, let me start with your written testimony. On page 2 you mentioned that in 1991 the Department made a deliberate decision, in your words, not to consolidate the exchange services. You then go on to say that you feel that decision was sound.

Is the evaluation or reevaluation of that system since 1991 ongoing? Are you still convinced that that's the proper course of action? Where are we in terms of 1995?

Mr. PANG. Mr. Chairman, I believe the decision that was made then was sound. As the gentlemen at this table described, the commissary and exchange systems are evolving. They are affected substantially by the drawdown.

The question we get to is, is there a way to privatize or consolidate our operations? The concern we have is that we maintain the benefit at the level that we have those benefits; both the exchange and commissary benefits at this point in time.

As you know, Mr. Chairman, this is a very emotional issue with our people. I know that when we were examining the commissary benefit last year, Secretary Perry received a great deal of input from people as he traveled about. He made a decision that he was not going to do much with the commissary benefit. In fact, he affirmed that he wanted the commissary benefit to be sustained at the current level. So, efforts internally to look at the commissary and pursue initiatives such as consolidation and the like were set aside, at least for the moment.

We are not unequivocally opposed to examining consolidation and privatization provided that the benefit levels are insured. That is where you really get into the difficulty of the matter. Every time we say that we are willing to look at something like this, people immediately assume that the benefits are going to erode.

In order to really do a thorough review of privatization or consolidation, in any type of study like that one might want to consider making these benefits, at least for analysis purposes, an entitlement. If you do that and establish that as the baseline, and seek ways to be more efficient, then I think people would be more apt to sign up to an effort like that.

Quite frankly, at this point in time in the Department of Defense, there is no active effort underway to seek either privatization or consolidation. There is an aggressive activity underway among all of my colleagues at this table to seek better cooperation and to achieve efficiencies for those needs.

I must state for the record that we are not unequivocally opposed to looking at consolidation or privatization with the understanding that the benefits as they exist today are not eroded.

Mr. BROWDER. Would the chairman yield?

Mr. MCHUGH. I would be happy to yield.

Mr. BROWDER. Secretary Pang, let me pursue that one step. If you were to be forced to make a choice, I am not going to ask you which one you would prefer, but if you had to make a choice, what would be the worst option, privatization or consolidation?

Mr. PANG. I think privatization probably would be the more difficult one because I don't know how you would preserve, for example, the commissary benefit the way it exists today. If you went to

privatization, I think people would be competing for contracts and would want the more lucrative contracts, the ones that produce the most revenue.

We have, for example, commissaries that are in some pretty remote areas where it probably would not make good business sense to contract out. I think if you were going to pursue one line or the other, consolidation probably would be the avenue that would probably be most useful.

Mr. BROWDER. Thank you. Thank you, Mr. Chairman.

Mr. MCHUGH. You are very welcome. Mr. Secretary, let me just state for the record, and I don't intend to speak for the other Panel members. They are certainly well-qualified enough to do that for themselves.

From my perspective, the No. 1 concern is the maintenance of that benefit as a part of the compensation package.

I felt it was important to allow you the opportunity to expand on that because it is a part of your written statement. Without putting words in your mouth, I hope you are suggesting that there is no active effort in the Department at this time. Insofar as you are aware, there is no analysis or number that would suggest that that's the direction you should be going in, or that your 1991 decision should be reworked.

Mr. PANG. At this point in time, that is correct, sir.

Mr. MCHUGH. Thank you. We are rather time constrained here. We have another meeting at 1 o'clock. I want to make sure that the other members have an opportunity to address their questions.

I don't like the 5-minute rule. I think one of the advantages of this Panel is that, indeed, the size permits us to avoid that. So, let's try not to play with the green and red lights. If the members will respect the time constraint, I am sure we can work through that.

With that, let me recognize the ranking member, Mr. Browder.

Mr. BROWDER. Thank you, Mr. Chairman. I will address this question to Secretary Pang or any other member of the witness panel. Could you describe your experience in receiving residual value of funding for the disposition of facilities overseas?

Mr. PANG. Mr. Browder, I don't think we have been very successful. That is a general answer. I think each one of my colleagues at the table can give you their experience.

General SWARTS. Sir, I will start. To date, I agree with Secretary Pang. We have not very been successful.

In Europe today, we do have an ongoing project in the approval cycle under a program called Payment In Kind from the German Government. That is for an \$8.1 million new exchange facility in Wertzberg in Germany. That is working its way through the Army and the JCS approval cycle. We are hoping to have that started sometime next year.

That will be our first application of residual funds, if you will, residual value for exchanges and exchange activities that have long since been eliminated in Europe.

Mr. BROWDER. What seems to be the problem for the lack of success?

General SWARTS. Sir, I'll characterize it in two ways. One, there is only a limited amount of money. We have to compete. We are allowed to compete.

When we bring our projects forward to the leadership in the Army, Air Force, and the Department of Defense, we have to bring those very competitive projects for resale to compete against known readiness requirements as you move troops, soldiers, and airmen around inside of Europe. I think that is the main problem, sir. It is just a matter of time. We need to get in line.

Mr. BROWDER. Other members of the witness panel?

General BEALE. Sir, on the commissary side, we have received nothing in terms of residual value. We have had a bit of a break from the Government of Japan through the Japanese Facility Improvement Program, wherein we received about \$22 million for new commissaries at Sugi Naval Air Station and Horeo Housing at Naval Station Sasabo in southern Japan.

We received \$13 million for a central distribution and warehousing facilities that we use on the Island of Okinawa. There is a project on the books for a replacement commissary at the Yakoda Air Base in conjunction with a shopping complex with the Army-Air Force Exchange Service.

We are pursuing several other projects. Basically, that has been the type of assistance that we have received. It has pretty much been limited to the Government of Japan.

Admiral KAVANAUGH. We haven't closed anything overseas from our Navy exchange standpoint.

General JOY. Sir, as I mentioned, we closed two small exchanges. We transferred both of those facilities to the other services, to AAFES and NEXCOM. We did not receive, nor expect, any compensation for the facilities. They are fully depreciated. As you can imagine in Panama and in Guantanamo Bay, they were old facilities.

Mr. BROWDER. Thank you, Mr. Chairman. I am finished with my questions.

Mr. MCHUGH. Thank you. As is the custom of the full committee, we are going to recognize members by seniority at the time the gavel fell and, thereafter, as they arrived at the hearing. I would like to recognize the gentleman from Virginia, Mr. Sisisky.

Mr. SISISKY. Thank you, Mr. Chairman. Welcome to all of you gentlemen. A week or so ago we had a hearing at which time I brought up something. As a matter of fact, three members of this Panel brought it up. Admiral Kavanaugh, I won't pick on you, but I have got to direct it right to you. We shot the warning shot so you could be prepared over here today.

I look at your statement and on page 3: "Our mission today as stated in our strategic plan is to provide our customers quality goods and services at a savings to support the Quality of Life Program." Then further down, "providing quality merchandising and services at a savings to the worldwide Navy community."

I asked our staff to get something from the Pentagon and did. On top of it, I asked our staff to make an unofficial study.

Mr. Chairman, I come from the Hampton Roads area where there is a very large Navy concentration. Unfortunately, I get the calls, and I am sure some of my colleagues from Hampton Roads

get the calls also. It has to do with cigarette markups. Obviously, with the commissary it is no problem. You buy it and charge 5 percent. I don't know how true these figures are. AAFES' average markup, as I have been advised from someone at the Pentagon, is 22 percent. The Navy is 33 percent. When I sent someone locally, I got another figure which really disturbed me.

The premium cigarettes had a 28-percent markup, but the discount cigarettes had a 58-percent markup. The deep discount, which was generic, as I have it was 49 percent. AAFES, you were as guilty too. You had a 51-percent markup.

The amazing thing was that when we went into Sam's Discount Store, the premium is at a 22-percent markup and the discount is at a 25 percent markup. I compared figures where the Navy runs the commissaries and the PX's in six locations.

We are not even talking about increasing sales of cigarettes. It has nothing to do with it. Either they are going to buy it at the commissary or they are going to buy it at the PX.

A private in the Army, Air Force, and Marine Corps, and a seaman draw the same salary at the same rate. I am disturbed that if you take one product, what is happening to other products there?

I thought that our first mission is to sell quality goods at a price that would be more than competitive on the outside. Admiral Kavanaugh, I understand there is no problem with the milk. Obviously, you have got to take care of your overhead. I can understand why the commissary can sell it cheaper. I think most people can, although I get the calls.

What I can't understand is how we vary in this markup. Some people have told me that this may be a social policy. I didn't think that our stores do social policies, because if you do, I can tell you another social policy that you are not doing.

What I would like, if you can come back at me now and tell me these figures are wrong or make a study within the next 3 weeks for me on what the markup is. This has nothing to do with increasing the sales of cigarettes. Basically, they are either going outside of the gate to get them or they are going to the commissary to get them.

It is a matter of fairness. Plus, let me tell you something. I come out of the business world. I learned one thing in business. There are some things that you make money on and some things that you make money with. If people are going out of that gate to buy products, that means you are going to sell less products in your store, not just cigarettes.

If they come in to buy cigarettes, they may buy something else. If they go into Sam's or Wal-Mart, they may buy something else there. It just makes good business sense to me. I know what you are using the profits for.

I am also disturbed—where I really get my critique is when these ships leave; not only are you charging them a high price on the ships, you are charging them tax on top of it, where captain of the ship or the exchange doesn't even pay the tax. Somehow, this is wrong.

I am not going to get into Fort Story. I will get into that later, if I have time. These are all problems. They are local problems, I agree, but I think they have national implications.

This is not, I repeat "not", to increase the sale of tobacco products. It is to do what is right for the people who you represent—to sell at the best price that you can get.

If you want to comment, then I will come back later.

Admiral KAVANAUGH. Since it was addressed to me, I think General Swarts will probably want to respond too. In answer to the key points you raised, if cigarette pricing is so high, what is everything else doing?

It has allowed us to price everything else much lower; the necessities, the milk, the pampers, the stuff we have for the lower grade enlisted families that need the benefit. That if they can't get to the commissary, they go to the exchange, or they want to buy our super value clothing.

It allows us to have a very, very small markup because we mark cigarettes up higher. We don't shop AAFES. They are not our competitor in Langley. They are in Pearl, in Anderson, and in Guam, but they are not in Norfolk.

Every three months, we go out and do a full industry study on cigarettes. The last one we did had the Navy Exchange selling them at \$14; Sam's at \$13.95; K-Mart at \$16.39; Food Lion at \$16.60; Wal-Mart at \$14.25; 7-11 at \$15.98; and Revco at \$16.40.

Obviously, our studies have to get together to see why our numbers are so different. Navy leadership would prefer we don't sell cigarettes in five or six commissaries or in any exchanges.

Mr. SISISKY. May I get a copy of that directive to you?

Admiral KAVANAUGH. Sir?

Mr. SISISKY. The directive that says that you do not want them to—

Admiral KAVANAUGH. This is just my marketing study where I send people out.

Mr. SISISKY. No. I am talking about—

Admiral KAVANAUGH. The Navy leadership one?

Mr. SISISKY. The Navy leadership one.

Admiral KAVANAUGH. Yes, sir.

[The following information was received for the record:]

NOV 2 1964

ZYUW RUENAACTT2 2862337

NAVOP 026/82

MSCIP/GENADM/PERS-65/L

SUBJ/SHIPS S ~~SECRET~~ TOBACCO PRICE INCREASE//

THE PURPOSE OF THIS NAVOP IS TO PROVIDE POLICY ON PRICING SHIPS STORE TOBACCO PRODUCTS.

2 THE SURGEON GENERAL OF THE UNITED STATES HAS IDENTIFIED THE
3 SMOKING OF TOBACCO PRODUCTS AS THE SINGLE MOST IMPORTANT PREVENTABLE
4 CAUSE OF DEATH AND DISEASE IN THE U.S. SHE HAS STATED THAT TOBACCO
5 USE IS RESPONSIBLE FOR MORE THAN ONE OF EVERY SIX DEATHS IN THE U.S
6 IT IS A MAJOR RISK FACTOR FOR DISEASES OF THE HEART AND BLOOD
7 VESSELS. MOREOVER, PASSIVE OR SECOND-HAND SMOKE CREATED BY TOBACCO
8 PRODUCTS ALSO CAUSES DISEASE, INCLUDING LUNG CANCER, IN HEALTHY
9 NONSMOKERS AND SEVERE RESPIRATORY PROBLEMS IN YOUNG CHILDREN AND
10 INFANTS.

3. THE U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES HAS INCLUDED THE MILITARY SERVICES AS A SPECIAL TARGET POPULATION FOR THE HEALTHY PEOPLE 2000 TOBACCO REDUCTION GOALS. AMONG NAVY'S GOALS ARE TO CREATE A SOCIAL AND WORK ENVIRONMENT THAT DISCOURAGES THE USE OF TOBACCO; PROVIDE A WORKPLACE THAT IS FREE FROM TOBACCO SMOKE; INCREASE EDUCATION AND PERSONAL AWARENESS OF NICOTINE ADDICTION AND HAZARDS OF TOBACCO USE; AND PROVIDE PROFESSIONAL ASSISTANCE TO THOSE WHO WANT TO STOP USING TOBACCO.

4. IN OUR CONTINUING QUEST TO ACHIEVE A SMOKE-FREE NAVY AND EMPHASIZE THE MANY POSITIVE BENEFITS OF A PHYSICALLY FIT AND HEALTHY LIFESTYLE, NAVY WILL RAISE THE PRICE OF TOBACCO PRODUCTS SOLD IN SHIPS STORES TO MATCH NAVY EXCHANGE PRICES EFFECTIVE 2 NOVEMBER 1982. IN PORT, SHIPS WILL MATCH THE LOCAL NAVY EXCHANGE PRICE. SEA STORE CIGARETTES SOLD OUTSIDE 3 MILE LIMIT WILL BE SOLD AT THE OVERSEAS NAVY EXCHANGE TAX FREE PRICE. ON AVERAGE, TAX PAID AND SEA STORE CIGARETTES WILL INCREASE ONE DOLLAR AND FIFTY CENTS TO TWO DOLLARS AND FIFTY CENTS PER CARTON RESPECTIVELY. NEW PRICES AND PROCEDURES WILL BE ESTABLISHED BY NAVY EXCHANGE COMMAND. 5. THE INCREMENTAL REVENUE DERIVED FROM THE PRICE INCREASE WILL BE RETAINED AS SHIPS STORE PROFITS AND USED BY THE SHIPS RECREATION FUND TO FURTHER PROMOTE OUR PHYSICALLY FIT, HEALTHY NAVY.

6. RELEASED BY ADM F.B. KELSC II, USN.// BT

INFC ADDED PER NAVOP DISTRIBUTION/15OCT092/RER/D

CINC WASH DC

CRIG NOO(1)

INFO

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MCN-82258/43570

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PAGE 1 OF 1 -
142130Z OCT 92

UNCLASSIFIED

Enclosure''(1)

Admiral KAVANAUGH. A year and a half ago, the Surgeon General came out with a lot of antismoking things. Our Navy Surgeon General came on very strong with the CNO and said we should not be encouraging smoking by selling cigarettes in the exchanges at such a reduced price.

I am the middle man here, the messenger. I went up and took it on. I said, you can't not sell cigarettes because it is going to kill our MWR dividends. If people can't go to the Navy Exchange to buy cigarettes, if they have to wander off the base, or if they wanted AAFES to buy them, it is going to take foot traffic away from the exchanges, just as you said earlier.

We are going to lose sales. We are going to lose profits. The MWR dividends are going to be hurt and our sailors are going to be hurt. The Surgeon General understood that. It took awhile, but he understood. He said, all right. He came back to the CNO and said, then let's not encourage it by undercutting outside the gate so much. Let's sell it just outside the gate.

So, the task I have been given by the CNO is to price close to outside the gate. These prices I just quoted you are a 13 percent savings from outside the gate; not counting sales tax.

Mr. SISISKY. And not counting state tax also.

Admiral KAVANAUGH. No. We pay State taxes on cigarettes. I am pretty sure we do. We pay it on gasoline and on a lot of other things.

Mr. SISISKY. You don't pay it on alcohol, so why don't you pay it on cigarettes?

Admiral KAVANAUGH. In some States we do, sir. We pay it on gasoline sales. We pay a lot of sales tax; a lot more sales tax than most people understand. That is how we get to the pricing policy at \$14.

Last week, apparently the issue was that AAFES sells them at \$13.55; 45 cents cheaper. I assume Bob does that because he has to compete with the commissary. The commissary sells them for \$11.05. He kind of splits the difference.

We are caught in the middle of trying to become good healthy sailors and support readiness, and at the same time, providing that first part of my mission, lower prices, and the second part of the mission, still providing dividends.

Mr. SISISKY. I guess, Mr. Chairman, one of my problems relates back to an experience in March of 1993 when I joined the President of the United States on board the *Theodore Roosevelt* that was just exiting Hampton Roads on the way to the Mediterranean, the Adriatic, and other places.

I was on this huge aircraft carrier, and the chief petty officer said, Mr. Sisisky, would you join some of our people? I said, sure. I went downstairs and I couldn't even see in there. I mean, the smoke was just overwhelming, but they had set aside to smoke.

The enlisted people in there said, you know, I'm 21 years old, or I'm 19 years old. I am getting ready to go in harm's way. They didn't know where they were going over there at that time with Bosnia, Iraq, and other things.

They said, you know, I'm not old enough to make a decision whether I smoke or not. Make it hard for me, but at least allow

me to do it. I stand on that deck and breath in those fumes from the jet aircraft and nobody is saying a word about that.

But I can't make a decision? Social policy should not be in the retail business. You will go broke doing social policy in a retail business, unless you have a captive audience. To some degree, you do have a captive audience, and I don't think that is exactly fair.

I just bring this up to you. I understand what you are doing, and I will take this up with Navy leadership. I just don't think it makes good business sense to do social policy, because you are breaking it in other places. You are picking that product, which is legal in the United States. It is legal in the United States to do that.

I don't want to admonish you. I don't want to do that because you may be controlled. I would like to see the copies of that. I'm sure, Admiral, you have to take your orders. I understand that.



DEPARTMENT OF THE NAVY
OFFICE OF THE CHIEF OF NAVAL OPERATIONS
WASHINGTON DC 20390 2000

IN REPLY, REFER TO

4000
Ser MED-00A/JU231436
24 Mar 93

MEMORANDUM FOR THE ASSISTANT SECRETARY OF DEFENSE FOR HEALTH
AFFAIRS

Subj: TOBACCO USE REDUCTION

1. The Department of Health and Human Services has identified the military services as a special target population for its Healthy People 2000 Tobacco Reduction Goals. In response to this challenge the Navy is committed to a continuous reduction in the use of tobacco with our goal, a "Tobacco Free Navy."
2. The sale of tobacco products to service members and their families at a reduced price in our exchanges and commissaries is counter productive to our efforts. Until we break this paradigm we are fighting a losing battle with the problem of nicotine addiction.
3. As a first step, the prices of tobacco products sold aboard Navy ships in CONUS territorial waters were raised to match those in the local Navy Exchange in November 1992. The Navy further intended to increase the price of tobacco products in our Exchanges worldwide to match local community prices. Part of the increased revenue generated by this policy will be invested in programs that support tobacco cessation.
4. The implementation of these policies by the Navy alone will only drive tobacco purchasers to Army/Air Force and Marine Corps Exchanges and DoD Commissaries where tobacco prices are still discounted. To have the desired impact we need a DoD Policy that does not subsidize the sale of tobacco products in any of our Exchanges and Commissaries. Only through a standardized DoD pricing policy can we truly make a difference and reduce the health hazard of tobacco use.
5. To achieve this goal, I am requesting that you take the lead within the OSD staff to establish a standardized pricing policy within the Department for tobacco sales. This is an essential first step in improving the health and welfare of our beneficiaries.

D. F. Hagen
D. F. HAGEN
Surgeon General

Enclosure (2)



DEPARTMENT OF THE NAVY
OFFICE OF THE CHIEF OF NAVAL OPERATIONS
WASHINGTON, DC 20350 2000

IN REPLY REFER TO
Ser 09/3U501072
6 August 1993

MEMORANDUM FOR NAVY STAFF ESC MEMBERS

Subj: 4 AUGUST 1993 NAVY STAFF ESC MEETING

1. RADM Higgins briefed the Navy Anti-tobacco program. He presented the ruling by OJAG that using non-appropriated funds to fund an anti-tobacco campaign would constitute an improper augmentation of appropriations, but that MWR can support the concept of an anti-tobacco theme throughout existing programs (e.g., sports and fitness). Additionally, RADM Higgins responded to previous tasking that Independent Duty Corpsmen can dispense nicotine patches at the unit level with the following caveats:

- must be purchased with appropriated funds, and
- must be used in conjunction with a behavior modification program

The following points outline the future tobacco use prevention program:

- shift from cessation to prevention,
 - recruit education,
 - raise the price of all tobacco products, and
 - emphasize the dangers of "spit" tobacco use
- increasing dental costs
 - potential spread of TB
 - increased prevalence of oral cancer

The following tasking resulted:

- Navy Staff ESC Tasking 93-70

Tasking: Can we require page 2 entries to determine if a person does or does not smoke?

Action: N1

- Navy Staff ESC Tasking 93-71

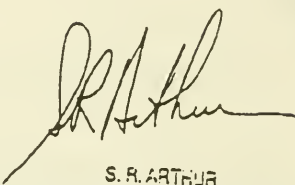
Tasking: Integrate anti-tobacco education into our recruit training and officer training pipelines.

Action: N7

Enclosure (3)

Subj: 4 AUGUST 1993 NAVY STAFF ESC MEETING

2. The next meeting of the Navy Staff ESC is scheduled for 18 August 1993. The next off-site meeting is scheduled for 25 August 1993.



S. R. ARTHUR
ADMIRAL, U.S. NAVY
VICE CHIEF OF NAVAL OPERATIONS

Copy to:
CNO ESC members
Navy Staff members

Admiral KAVANAUGH. I would be glad to do that.

Now, we have fixed the smoking policy on the ships, as I hope you are all aware. The CNO last year, well, it took awhile, but after that he came up with a policy that said there will be one place on every ship where somebody can smoke. We will sell cigarettes on board as ship stewards.

So, that issue is fixed. The Vice Chief committed to this committee last year that we would always sell cigarettes in the exchanges. He sent a personal letter to Mr. Lancaster that said we would sell cigarettes. I get pressure from some places, mostly at the hospitals, not to sell cigarettes in the exchanges, but we do.

The only way I help them in their program is to say, we will put the price up. When you are still saving 13 percent outside, that is a reasonable savings.

Mr. SISISKY. I would like for you to get me the prices. Where I really got clobbered is on the discount cigarettes. That is really not being fair.

A3 CIGARETTE PRICE SURVEY - PRICE VALUE
INERCOM \$11.00
* AAFC \$11.00
COST \$5.44 \$6.85

EAST COAST	CURRENT PRICES	PROPOSED PRICE	LOWEST COMP PRICES	LAST YEAR PRICES	WHISE CLUBS PRICES	MASS MERCANTILE PRICES	GROCERY EARTH FRESH	DISCOUNT STORES WALMART	CONVENIENCE ZEEVEN	DRUG BEVCO
NORFOLK	\$12.00	\$11.00	\$10.90	\$10.99	\$12.85	\$12.00	\$12.85	\$11.00	\$10.99	\$10.99
NEW ENGLAND	\$12.00	\$11.00	\$10.97	\$13.68			STGE SHOP 16 99/17	WALMART 16 99/17	MOBIL MART 16 00/17	CVS 17 00/17
MECHANICSBURG	\$12.00	\$10.00	\$9.90	\$12.94			GIANT \$15.50	WALMART \$11.00	ZEEVEN \$10.00	PHARMAD \$15.50
ONILGREN	\$12.00	\$9.00	\$8.35	N/A			FOOD LION \$9.99	YAVIS \$10.99	TEACQ \$8.35	
MEMPHIS	\$11.00	\$11.00	\$11.15	\$10.79			KROGER 12 99/140	WALMART \$11.01	SADGE SHOP 11 50/113	WALGREEN 12 95/128
JACKSONVILLE	\$12.00	\$11.00	\$11.65	\$12.97	\$11.65		ALBERTSON \$13.81	WALMART \$12.42	LIB CHAMP N/A	
ORLANDO	\$12.00	\$11.00								
ALL SOUTH CAROLINA STORES	\$12.00	\$10.00	\$9.30	\$10.44	\$10.91				BE STATION \$12.18	ECRERDS \$10.85
CENTRAL										
PENSACOLA	\$11.00	\$11.00	\$12.00	\$12.52			FOODWORLD \$13.69	WALMART \$12.89	TOM TULLIS \$14.98	ECARD \$14.89
MERIDIAN	\$11.00	\$11.00	\$11.65	\$11.04			WHH DINE \$12.22	WALMART	PASA SAS \$11.65	K&B DRUGS \$11.79
NEW ORLEANS	\$11.00	\$11.00	\$11.08	\$12.26	\$11.08		SCHWEG \$13.09		TIME SAYER \$11.09	ECARD \$11.69
GULFPORT	\$11.00	\$11.00	\$11.85	N/A	\$11.71		DEL CHAMP \$13.67		TMART \$12.99	BIG B \$11.83
CORPUS CHRISTI	\$12.00	\$12.00	\$12.77	\$12.52			HEB 15 99/189	WALMART 14 30/152	CIRCLE K 15 99/159	ECARD 15 99/152
DALLAS	\$12.00	\$6.90	\$6.90							AAFC \$8.90
GREAT LAKES	\$12.00	\$12.00	\$12.48	\$14.89	\$12.46		JEWEL \$20.19	WALMART \$13.38	SPEEDWAY \$16.99	E.M \$14.99
WEST COAST							LUCKY'S \$13.69	WALMART \$13.74	SANDY \$14.70	
SAN DIEGO	\$12.00	\$12.00	\$12.83	\$11.90	\$12.83		TARGET \$14.97			
PACIFIC WEST	\$11.00	\$11.00		\$10.50			PASIN SAGE \$17.74		WILLIAMS \$14.61	PAYLESS \$16.39
OAKLAND	\$11.00	\$11.00	\$11.00	13.99	\$12.95		LUCKY'S \$16.61			AAFC \$11.00
PEARL	\$11.00	\$11.00	\$11.00	\$11.00	\$11.00		SAFEWAY \$16.69	WALMART \$14.88	ZEEVEN \$18.89	ONEI \$17.99

* \$11.00 IS AAFC CORPORATE PRICE; HOWEVER EXCEPTIONS ARE MADE BASED ON
COMPETITION (EXAMPLE: HOMESTEAD AFB \$9.10, CARSWELL \$8.90)

A2 CH METTF PRICE SURVEY - GENERIC

NEXCOM \$9.00

* AAFFES \$1.25

COST \$9.81

EAST COAST	CURRENT PRICES	PROPOSED PRICE	LOWEST COMP PRICES	LAST YEAR	WHISE CLUB	MASS MERCHANT KAMART	GROCERY FARM FRESH	DISCOUNT STORES WALMART	CONVENIENCE 7 ELEVEN	DRUG BEVCO
NORFOLK	\$9.00	\$9.00	\$10.90	\$8.85	\$12.05	12.05/1.00		\$11.00	10.90/09	13.59/1.50
NEW ENGLAND	\$10.00	\$10.00	\$14.99	\$12.07			STOP SHOP 16.29/2.09	WALMART 16.97/1.07	HENRY PERRY 17.00/1.07	BROOKS 14.99/1.49
MECHANICSBURG	\$10.00	\$9.00	\$8.99	\$10.84			SHEETZ \$9.50	WALMART \$8.99	7 ELEVEN	PHARMOR \$11.00
DAHLGREN	\$9.00	\$7.00	\$6.99	N/A			FOODLION \$9.99	TEXACO \$9.99		
MEMPHIS	\$9.00	\$9.00	\$9.15	\$8.79			KROGER 9.08/1.15	WALMART \$10.43	SMOKESHOP 9.15	WALGREENS 9.89/99
JACKSONVILLE	\$10.00	\$10.00	\$11.84	\$11.80	SAMS \$12.09		ALBERTSON \$11.84	WALMART \$12.42	LIL CHAMP \$12.58	WALGREENS 12.59
ORLANDO	\$10.00	\$9.25								
ALL SOUTH CAROLINA STORES	\$10.00	\$9.00	\$7.80	\$8.44	SAMS \$9.20				BEVSTATION \$7.80	EGGERS \$9.05
CENTRAL										
PENSACOLA	\$9.00	\$8.00	\$8.00	\$11.86	N/A	FOODWORLD \$12.01		WALMART \$13.99	TOM THUMB \$14.59	ECKARD \$13.69
MERIDIAN	\$9.00	\$8.00	\$10.48	\$8.83	KAMART \$12.78	VOITH DIXIE \$12.22			PAK A SAK \$10.49	K&B DRUGS \$10.90
NEW ORLEANS	\$9.00	\$8.00	\$10.69	\$10.51	SAMS \$11.08	SCIENCEG \$13.09			TIME SAYER \$11.99	ECKARD \$10.69
GULFPORT	\$9.00	\$8.60	\$7.75	N/A		KAMART \$11.79	DEL CHAMPS \$13.85		IMART \$11.98	BUG B \$9.63
CORPUS CHRISTI	\$10.00	\$10.00	\$13.29	\$12.32	SAMS \$12.77	HEB 13.29/1.39		WALMART 14.39/1.52	CIRCLE K 13.99/1.58	ECKARD 13.99/1.58
DALLAS	\$10.00	\$7.75	\$7.75							AAFFES \$7.75
GREAT LAKES	\$10.00	\$10.00	\$9.98	\$12.86	SAMS \$11.48	VENTURE \$14.74	JEWEL \$13.36	WALMART \$13.36	SPEEDWAY \$10.99	GOLD PALACE \$9.99
WEST COAST										
SAN DIEGO	\$10.00	\$10.00	\$12.33	\$10.82	P CLUB \$12.33	TARGET \$14.97	LUCKY'S \$12.46	WALMART \$13.74	SAVON \$12.75	AAFFES \$9.25
PACIFIC WEST	\$10.00	\$9.25	\$9.25	\$8.50		TARGET \$10.39	FOOD PAN \$19.99	COSTCO \$14.54	CIRCLE K	AAFFES \$9.25
OAKLAND	\$10.00	\$10.00	\$10.69	\$13.00	P CLUB \$10.69	PAN SNAKE \$13.57	LUCKY'S \$16.23	WILLIAMS \$14.61	PAYLESS \$19.39	
PEARL	\$9.00	\$9.25	\$8.25		AAFFES \$9.25					

* \$9.25 IS AAFFES CORPORATE PRICE; HOWEVER EXCEPTIONS ARE MADE BASED ON COMPETITION (EXAMPLE HOMESTEAD \$8.16 CARSWELL \$7.70)

Admiral KAVANAUGH. I will give you the prices. I don't know what the cost price is. Dick probably does.

Mr. SISISKY. How would you know what the margin is?

Admiral KAVANAUGH. I'm not giving you the margin. I am doing price selection. In Norfolk, on the middle one you are talking about, we sell them for \$11; Sam's is at \$10.99; K-Mart is \$13.20; Food Lion is \$12.95; Wal-Mart is \$11.35; 7-11 is \$13.26; and Revco is \$13.26.

The real bottom, the generic, the ones at the bottom, we sell them at \$9; Sam's is \$8.95; K-Mart is \$12.95; Food Lion is \$10.85; and Wal-Mart is \$10.37. So, we are still substantially lower than everybody else.

Mr. SISISKY. You guys have a State tax down there in Virginia Beach and now you have a local tax too. You are competitive, but that is probably where the markup is.

General SWARTS. If I might just comment, sir, on the cigarette sell prices. Our system is a bit different. We do actively survey cigarette sell prices. I have actually seven levels of cigarette sell prices broken out within the three levels of cigarettes, between the premium brands, the mid-brands and the sub-generic.

We price, essentially, to provide a savings based on the outside the gate price; whether it would be in the Hampton Roads, Virginia Beach area, or in California, or wherever it might be; about 19 locations, where we have variations in price from our normal pricing policy that we would use across the United States.

Mr. SISISKY. That is interesting. Your price is not based on a percentage of markup, but on competition.

General SWARTS. It is based on both, sir.

Mr. SISISKY. What do you do on other products?

General SWARTS. We do the same thing. We have about 250 items that we survey, in fact survey weekly and price those items. Most of them are necessity and convenience items like toothpaste, paper products, and things such as this.

We survey all of our competitors outside of the gate and adjust our prices either daily or weekly. We generally try to do it weekly to beat the competition. The beat is 1 cent below on an item that sells for less than 1 dollar.

Mr. SISISKY. Even if you lose money on it?

General SWARTS. Even if we lose money. It is traffic.

Mr. SISISKY. I understand that.

General SWARTS. You understand that as much as I do.

Admiral KAVANAUGH. And yes, sir, we do that.

Mr. SISISKY. Well, I'm taking too much time. Let other members go, and then I will come back.

Mr. MCHUGH. Mr. Ortiz.

Mr. ORTIZ. We are going to give him a hearing by himself. I have a question for General Beale. Last year, this committee was greatly concerned about the funding level for the commissary system and added an extra \$30 million to the authorization bill to enhance commissary funding.

The appropriators also followed the lead of this committee and provided an additional \$30 million in funding. What is the status of this money? Has DeCA actually received this additional funding

and, if so, what is it being used for? What benefits do the patrons get? Maybe you can enlighten me a little bit on that.

General BEALE. Sir, it was actually withheld by the Department. I received what was in the President's budget request; no more, no less.

Mr. ORTIZ. So, you haven't seen the \$30 million?

General BEALE. No, sir. It is held at the Department level and, in essence, will be applied to next year's appropriated request.

Mr. ORTIZ. Mr. Secretary, what happened? He indicated that the money has never been received. Where does it stand? What is the problem?

Mr. PANG. The position of the Department is that the commissaries are adequately funded for fiscal year 1995 without additional funding provided by the Congress. However, we will use those funds, as General Beale indicated, for the subsequent year. My question to General Beale is, do you need this money in 1995? I will be happy to entertain this.

General BEALE. Have you ever been between a rock and a hard place? The answer to Mr. Pang's question is this. We could always use additional money.

On the other hand, we have been going through some serious belt tightening. The additional \$30 million could, theoretically, if applied against my operating account create problems for us downstream unless it were repetitively given.

Frankly, sir, in anticipation early on of receiving it, we had looked for ways to spend it that would not necessarily have gone to plus-up our operating account. In essence, what it provided us was seed money capability to achieve even greater savings in some areas that we were struggling with.

For example, we could have used about \$8 million to enhance our training. Our turnover of our store personnel is one of our biggest problems. We never really have enough money to put into training.

We could always use additional money to enhance our automated capability, particularly our long-line communications systems working with DISA that would give us the capability to quickly move data around the world in an electronic environment.

There were other equipment type enhancements. In fact, we could have used the money to provide labor saving capability down at the store level.

I would have been very concerned had we put \$30 million into additional operating hours because had we done that, we would have been faced with the same situation that I faced last year when my predecessor, under the best set of circumstances that he could have envisioned at the time when he put \$17 million of our first year's savings back into additional operating hours, we were faced last year with a situation of having to take that away.

There was always some reluctance on my part to apply that against operating costs, given the belt tightening that we were being expected to achieve. On the other hand, there were a number of ways that we could have spent the money that would have enhanced our overall capability, but would not have made us reliant on an additional \$30 million over and above the President's budget request on a continuing basis.

Mr. ORTIZ. I can understand that. When we heard testimony and we talked to some people, there was no question that there was a need to help with the problems you were having, especially when you downsized and you don't have that business coming in that you were accustomed to.

I have another question, but I don't want to take too much time. I know that our ranking member asked a question about the possibilities of whether commissaries are privatized and all of that. Can you go into that in more detail? Is it good for the patron?

General BEALE. Admiral Kavanaugh said he gets the question all of the time, why is milk \$1 in the commissary and \$1.25 in the exchange? The question that I receive all of the time, sir, is why can't you operate like the Safeway, if you are on the East Coast, or HEB if you are in Texas, or Lucky's if you are on the west coast?

There are a couple of key reasons that I would like to lead with and then I will get down to the very heart of your question. I have two charts that I carry with me all of the time that, basically, address why up-front we can't operate like the Safeway.

I mentioned in my opening statement two of those issues. First of all, 46 percent of our budget goes to support our overseas operations in our CONUS remote locations. The second is this little chart that I carry that shows how the sales patterns of our 333 stores at the end of fiscal year 1994 were rated.

I will just run across the bottom. It will give you an opportunity to see the point that I am making. In commercial grocery chains, service is driven by sales and profits. In the commissary, service is basically driven by the level of appropriated funding.

Here are the mechanics on the sales that impact the way we do business. Twenty percent of our sales come from 19 stores, out of 333. One-fifth of our sales come from 19 stores or 18; 19 was last year's. It is 18 now. Forty percent of our sales come from 44 stores. Sixty percent of our sales come from 82 stores.

The figure that I quoted in the text in my opening statement was that basically 80 percent of our sales come from 141 stores or 43 percent of our stores. That means that this big column over here on the left-hand side of the card says that 57 percent of our outlets are only generating 20 percent of our sales.

If you gentlemen were operating a commercial grocery chain and 57 percent of your outlets were only generating 20 percent of your sales, they would be on the chopping block. They would be on the chopping block.

We are not in the business to make a profit. We are in the business to provide a service as are these gentlemen. I'm not the only one who has unprofitable operations in terms of a bottom line.

You have got the fact that service is driven by sales in the commercial sector, by appropriated funds in our sector and then these constraints that basically say, your overseas operation is a sunk cost to the Department.

With my best professional judgment, I cannot imagine any grocery chain in America that could take the overseas or CONUS remote locations, or even the 20 percent over on this column and make a profit.

In fact, in the past, most of the attempts by commercial industry to get their fingers into the commissary business have been on a

cherry-picking basis. They would love to have the military district of Washington, the bay area of San Francisco, the greater Los Angeles-southern California area, and the Tidewater area of Norfolk. But nobody wants to go to Grand Forks, ND; Mountain Home, ID; Dougway, UT; or the National Training Center at Fort Erwin, CA where the nearest grocery store is an hour away.

If they think they can go overseas and make a profit, then I think they have got blinders on. This is what they would be up against overseas. First of all, the Congress would have to make a decision as to whether or not if you privatize the commissaries overseas you are going to permit the contractor to ship goods as government cargo on U.S.-flag carriers, at U.S.-flag carrier rates, or whether you would permit him to use the cheaper rates on foreign-flag carriers which would subject him to taxes, tariffs, inspections, and everything else when he hit the port on the other end. He would be lucky to get the groceries to the store for sale.

The other part of it is this. In the continental United States there is no single grocery chain that covers the 48 contiguous States, let alone the 50 total States in territories like Guam and Puerto Rico.

Therefore, if you were to contract out through privatization, you, in essence, would have to go into the 52 competitive commercial grocery markets in the 50 States and figure out how you were going to slice up the bacon.

Even if you presumed, because of labor rates, that a contractor could do it for a little bit less with some type of subsidy, the contract administration costs of 20 or 30 different competitive areas is going to run you right off the charts.

The other point is this. With regard to privatization, we sell at cost plus 5 percent. In the commercial sector, the average gross profit for chains without distribution capability is 23.4 percent and with distribution capability is 24.8 percent.

Even the everyday low-price formats are working on a gross margin of somewhere around 18 to 20 percent. Nobody can sell groceries at cost plus 5 percent and make a profit; nobody; not even the gentlemen to my left. I agree with Secretary Pang on privatization. Privatization would be by far the worst of any other option that would differ from the current format.

Again, I go back to my statement. If somebody can prove to me that they can sell groceries at less cost to the taxpayer than we can, given the constraints of the system, and oh, by the way, what are we going to do about the socioeconomic programs that we support? If anybody can come in and prove it, let them bring in their balance sheets and we will take a look at them.

Mr. ORTIZ. Let me say that you all have done a good job. I don't think I could do it. I don't think 7-11 would be competitive.

General BEALE. Sir, could I take a moment? This is important. Mr. ORTIZ. Yes.

General BEALE. There is one other point that I really need to make. If you privatize the commissaries, if it were a good idea, the decisionmakers have to understand the relationship between the commissaries and the exchanges.

These gentlemen to my left will tell routinely that 35 to 45 percent of their sales come from the commissary business. If you tin-

ker with that formula—it is what I referred to a couple of years ago before this group as the domino theory—and you move one of the dominos, then you are likely to get some unanticipated results which are going to be tremendously lower exchange profits and then tremendously lower MWR dividends and the whole system comes down.

Mr. ORTIZ. I am just like my good friend here. I have many questions, but I will submit them for the record. What other things have you seen impediments or trying to make roadblocks along the way?

General BEALE. There are a couple of things that could help us with a little bit of relief. It is my personal opinion that I am giving you because none of these have completely cleared the Department.

If I can speak under those circumstances, I'd be happy to address the question or we can submit them for the record.

Mr. ORTIZ. Whatever the Chairman, if you will allow. I don't want to take all of the time.

Mr. MCHUGH. Well, you have already done it.

Mr. ORTIZ. Now he is chastising me. Go ahead.

General BEALE. The first thing, sir, would be the Comptroller General's decision of a few years ago called the Mattress Decision, which particularly hampers DeCA's ability to engage in full exploitation of cooperative efforts between the exchanges and the commissaries.

While the initial decision applied to the purchase of mattresses by an Air Force unit overseas, the interpretation of that decision over the years has been extended to virtually all goods and services.

Mr. SISISKY. Would the gentleman yield?

Mr. ORTIZ. I will yield to my good friend.

Mr. SISISKY. Are you talking about joint purchases? Is that what you are talking about?

General BEALE. It could extend to that, but I'm not even going that far. I am just talking about cooperative efforts which would allow us, for example, to buy time on the AAFES satellite to move our transmission data as opposed to having to use commercial lines to do such things as take advantage of the AAFES business network to train our people.

Mr. SISISKY. Who made this decision?

General BEALE. It was the Comptroller General, sir. It was the Comptroller General's decision of the late 1950's. It has been around for years. It is basically the decision that everyone refers to when we try to engage in cooperative efforts with the military exchanges.

Mr. SISISKY. We can take care of that. We will try to help you with that.

General BEALE. Sir, without elaborating any further, if we could get a change to that one Comptroller General decision, it would give us the flexibility to save a lot of taxpayer dollars and a lot of service member dollars.

Mr. BATEMAN. Would the gentleman yield?

Mr. ORTIZ. I yield to my good friend, the chairman of the Readiness Committee, Mr. Bateman.

Mr. BATEMAN. I just want to offer the comment that I think General Beale's presentation has been a brilliant one. The only thing I would offer any criticism for is why haven't we known about this a lot earlier if it has been around since the 1950's? In all of the years that I have been on the Panel, I don't remember ever hearing of it as a problem. I would have liked to try to have solved this earlier rather than later.

General BEALE. Sir, I think the answer to that question is that until the last couple of years when the reduction of appropriated dollars created such an impact on our ability to provide service, it just wasn't that much of an irritant. Now, it is an irritant and, in fact, a major stumbling block.

Mr. BATEMAN. I thank the gentleman.

Mr. ORTIZ. Thank you, Mr. Chairman. And thank you, General Beale for your fine testimony.

Mr. MCHUGH. Mr. Underwood.

Mr. UNDERWOOD. Thank you, Mr. Chairman. Not to belabor the point about privatization, but since the beginning of this year we have had at least a dozen press reports that various senior members of the Budget Committee are entertaining the proposal to privatize some of the activities that you are engaged in.

I think we have to stand vigilant on those issues. I see them very much and very strongly as a part of a contract with the people in uniform, and particularly with retirees. As downsizing occurs, and things like that occur, it really puts a lot of people in a bind. I understand that you are in support of that.

Just for the sake of clarification, General, earlier Mr. Ortiz was asking about the \$30 million that they tried to give you that you never received.

You also mentioned in your testimony that there were a number of savings that you have engaged in in this past year. What happens to those savings in terms of actual money? Where does that money go?

General BEALE. Sir, that's a good question. I don't have it anymore. In essence, what we did was, we were asked by the Department to take a good, hard look at ourselves and try to identify every possible area of cost reduction that we could possibly think of in order to reduce the burden of the commissary appropriation on the taxpayer.

Our initial assessment, which was reported to the Department late last summer, after almost 6 months of work, was that we could save the taxpayer about \$162 million of operational costs by the end of fiscal year 1996.

That has subsequently ballooned to over \$220 million by the end of fiscal year 1997. In essence, what happened was when we laid those numbers on the table, the fiscal year 1995 program or budget in the subsequent program years of 1996 and beyond were adjusted.

So, in essence, the Department asked for less money from the Congress than it would have had to, if we had not laid those savings on the table. If you go back to the time that I assumed command of the commissary agency in late November 1993, the appropriated line for the then-year budget and the program as far as it

went out at that time, which I believe was around 1998 or 1999, had well over the billion dollar mark consistently.

We are just over a billion dollars this year. Next year, our appropriated line is actually less than \$900 million with the credit that we have with the Department for the \$30 million and some other money that is available to us. So, our total cost authority next year will be \$945 million. It will drop a little below that the following year.

When we are able to field our new business systems and our new front-end systems beginning in fiscal year 1997 and extending through fiscal year 1998, we should be able to generate another, in our estimate, somewhere between \$75 million and \$100 million of additional savings in the outyears to contribute to reducing the overall burden on the taxpayer.

The savings, in essence, were just programmed out of the defense budget and program request. I think it is simply money that the Congress never had to deal with as opposed to the dollars going somewhere else.

Mr. UNDERWOOD. Mr. Secretary, do you have anything?

Mr. PANG. Mr. Underwood, the Department does a midyear review of its 1995 program. At that point, because of the experience that we were having in 1995 where we had operational deployments which were unprogrammed and unplanned, there was a very, very tough look at operation and maintenance money to see what efficiencies people could generate so that some of these monies could be used and applied against readiness requirements and training.

Quite frankly, the efficiencies that we were able to extract out of commissaries and other operations really went to other accounts. The fiscal year 1995 budget level remains unchanged. These are the total amounts. The aggregate amount remains unchanged. The money was simply moved around.

Mr. UNDERWOOD. It just seems to me that one of the main arguments against privatization is to actually show a reduction in cost as a savings to the taxpayer. If the money is just shifted around, then it is not clearly explained. I think it undermines and actually supports people who are arguing for privatization.

I would urge that that money be somehow shown to be a net savings to the taxpayers. General Beale, in your testimony you mentioned that 57 percent of the stores would be classified as losers.

Obviously, under any kind of privatization scheme, no reputable firm would be interested in those. Could you characterize that? Does that include Guam? Not that you want to characterize that as a loser.

General BEALE. No, sir. In fact, our sales at both Anderson and Arote are very robust. The issue is in terms of the profit since we don't have a bottom line because we are providing service based on a specified level of appropriated dollars. When a private firm would look at the potential—you see, this is the big problem that they have whether you are talking about the National Training Center in Fort Erwin, CA, the military community in Heidelberg, Germany, or the military community in Tokyo, Japan, or the greater Tokyo environment. In essence, they really don't have the potential

to capitalize on increasing sales because they have a captive audience.

There is nothing you can do to increase sales at the commissary at Fort Erwin, CA, despite your best efforts because there is a specific number of people that live at Fort Erwin and that is not going to change appreciably from time to time. They can do everything they can possibly think of to try to compete against the grocery stores in Barstow, CA, and it won't make any difference at all.

In essence, you are playing to captured markets. So, when I characterize these stores as losers, it is certainly not in the context of the service we provide because that is what makes them winners. A commercial grocery chain, in essence, would look at those and say, oh, good grief. You mean I have got to go with this?

That is why I am very skeptical of all of the proposals that I hear about from time to time where a group comes in and says we can run it, we can run the grocery stores and the commissaries for 60 percent of what DeCA is doing. I am saying, boloney.

Mr. UNDERWOOD. I appreciate that point very much. For the record, if all of you, both the exchanges and the commissaries, could provide some information over time about the shifting nature of your customer base between active, reserve, and retirees, I would appreciate it.

I think some communities are very much disproportionately impacted by that. I don't know about Fort Erwin. I don't know whether many people retire and live around Fort Erwin, but certainly in the case of Texas, like Guam, a lot of people are coming back home. It is changing the customer base. That is a very important issue.

General BEALE. Yes, sir.

Mr. UNDERWOOD. Lastly, Admiral Kavanaugh, you briefly talked on the BRAC issue. This is the entire MWR network. In the case of closing facilities under BRAC, and one facility in Guam was closed, is there a general pattern of what happens to the employees in the exchange?

I understand, and I hope it is accurate, that as a result of the closure only one employee was not placed. Do you have any comment about that since we are facing the possibility of other naval activities winding down?

Admiral KAVANAUGH. No. I know that is a fact for Guam. I track all of the closing of Navy exchanges. We do it well in advance. Probably 50 percent of my employees are not full-time type employees. Probably another 25 percent are part-time employees. So, the only people that you have a hard time placing are the full-time employees. The career people that I direct over there, I send over there and then move them someplace else. We have not had a problem in Guam. We have had no problem at the Navy Training Center in San Diego. We have moved those people.

The next place I have is Philadelphia and Charleston. We are in the process of moving the career people. If we can't place them, then they will go on unemployment.

Right now nonappropriated funds have picked all of that up. We are all opposed to that. I have booked \$4 million in BRAC costs within the Navy. I have got \$1.5 million back and with promises of the other \$2.5 million.

Again, it is a priority issue. There are only so many BRAC dollars for closing bases. Then the base commanding officers and the comptroller have to decide what they are going to book it to. Whether they are going to take care of the unemployment compensation for their NAF employees so that sailors don't have to pay for that, and they shouldn't have to pay for that, or for environmental cleanup and go back and ask for more money. It is just a pure priority issue on closing bases. We have been doing fair on getting our fair share.

Mr. UNDERWOOD. Thank you very much.

Mr. MCHUGH. I thank the gentleman. Mr. Pickett.

Mr. PICKETT. Thank you, Mr. Chairman.

I want to welcome our witnesses today. Secretary Pang, I think you know that, in the business we are all in around here, unexpected events sometimes can drive peculiar decisions which brings me to my question about the financial control mechanisms in the resale system; not so much in the commissary side as in the exchange and MWR side.

I understand that the DODIG is personally conducting an audit of the military exchange system financial control mechanism. I would like to know whether any such program of auditing requirements is in place today with respect to MWR and exchange activities? When do you expect this report from the DODIG will be completed? Would you anticipate having a requirement for some kind of audit responsibilities in the future?

Mr. PANG. The answer is yes, Mr. Pickett. The DODIG report, I'm told, is in the final stages of completion. As soon as we get that report cleared, we will provide it to the Panel.

Mr. PICKETT. I think the financial integrity of all of these operations is very important. If it were to become public that some kind of egregious activity has taken place someplace, it could undermine confidence in the whole system. I would urge you to move ahead with some kind of a program audit requirement that is uniform for all of the activities over which you have responsibility.

Mr. PANG. Yes, sir. In fact, I met with our new DODIG, Eleanor Hill, and we chatted about this. This is an area I think we are going to explore further. The audit responsibility falls under her purview. I would like, with your permission, to ask my colleagues at the table to—

Mr. PICKETT. Well, if you are going to be doing this, Mr. Secretary, I'll just wait to get the information.

Mr. PANG. I appreciate that very much.

Mr. PICKETT. The other question I have relates to the distribution of alcoholic beverages. We seem to have a changing environment about the way this product is handled. We go from allowing local authorized dealers to provide the product, to centralized purchasing and storing of the product, and a mixture of these two approaches.

If I recall correctly, in last year's DOD authorization bill, two jurisdictions, I think it was Alaska and Hawaii, were mandatorily made by statute to require that these products be provided by local distributors.

We know that DeCA has made huge strides in just-in-time delivery where they have products delivered to the shelf. There is no storage, warehousing, or double handling anywhere along the way.

So, it seems strange that the distribution of alcoholic beverages is beginning to be brought in-house for purchasing these, storing them in inventory, getting them out, and distributing them to the points of distribution. Can you tell me what the policy is on this and what you expect to do in the future?

Mr. PANG. Mr. Pickett, I believe this is a matter that is under study and that a report is due fairly soon. When you look at the cost savings involved in general, I believe the report will show that it would probably be more advantageous to purchase directly from the producers than from the distributors.

Mr. PICKETT. Who is preparing this report? When is it going to be available?

Mr. PANG. Let me ask my staff.

Admiral KAVANAUGH. The answer is that the CPA firm was contracted to do it, and the report has been submitted to OSD. It is being reviewed, I assume. So, it should be going over.

Mr. SISISKY. Would the gentleman yield?

Mr. PICKETT. I would be happy to yield.

Mr. SISISKY. GAO, I think, has done a report; have they not?

Admiral KAVANAUGH. No. You all asked OSD to have an independent assessment from a certified public accountant look at it, which they have done. What we are all doing, and it goes back to your issue on pricing and markups. It is the same issue. It is a business-based decision.

I would hope that they wouldn't come out with any policy that would say that we have to go one or the other because we do whatever is most effective for the sailor. I use a lot of distributors to provide hands-on delivery to the package store. But they won't go up to Winter Harbor, ME, any more than once or twice a month.

Then I have to stock a huge inventory up there that I have to pay for and sailors have to pay for the cost of the inventory because we have got to borrow money to do that. I bring it in for them and then I can ship it up, a half a case at a time, or a case at a time through my normal distribution system because I have got a truck going up there anyhow.

Mr. SISISKY. I think that is what GAO added in your distribution cost. It costs money to put something on a truck. I know, because I ran enough trucks.

Admiral KAVANAUGH. Absolutely.

Mr. SISISKY. Would the gentleman yield?

Mr. PICKETT. Happy to yield.

Mr. SISISKY. Let's just take Hampton Roads. How do you buy your alcohol?

Admiral KAVANAUGH. Most of the alcohol for Hampton Roads is probably bought through distributors because there are three big exchanges that they can shop. However, if I get a better price from the major distiller, I will buy it from him, put it in the distribution center there in Norfolk, and then ship it out as I ship everything out. I make daily shipments to those three big exchanges every day.

Mr. SISISKY. Do you have to order by truckload?

Admiral KAVANAUGH. Yes, sir, I assume. It would come in one major truckload to the warehouse. Then, I have got the other trucks going out anyhow. There is a sunk cost in those trucks going to those exchanges every day.

General SWARTS. Mr. Sisisky, if I may jump in here as well. I also distribute alcohol in the greater Norfolk, Hampton Roads area through the Dan Daniels Distribution Center. We do this on a cost per case basis to include the cost of the whole inventory, the cost of transportation of the case, the cost to handle the case through the distribution center, and the cost to procure it.

That then is developed as a baseline. Then we compare the distributor's delivered cost against that number. We buy from the cheapest place, sir.

Mr. SISISKY. Let me tell you what the fear is. This may have changed, but when I was out in the business world—and I am not anymore—I used to buy by the trailer load, once a month, twice a month, or whatever it was. You would then put it into a warehouse. You would have a brand X. When you sold out of brand X, you have got to wait for the next shipment. You can't call the distributor up and say, deliver me brand X. Do you know what they used to say? Let them drink something else.

Our customers are not second-class citizens, and that is exactly what happens. I don't know if it is happening now, but I know that in the past it did happen. When you would run out of a brand, you would have to wait 2 weeks until you got your next delivery. I don't know whether this is happening now. I really don't. I know how it used to be. Let the customer be damned because they will drink what we give them to drink.

General SWARTS. I think that is possibly one of the reasons this Panel and the committee directed that the class 6 stores be moved out from under the installations and be put under the exchange systems as they are today so we could put them into modern business type practices so that we don't end up, well, you get brand X and that is all you get. I know, sir, because we worked that problem very hard.

Mr. SISISKY. Good.

Mr. PICKETT. I find it unusual that, in the case of the commissaries, they find that it is beneficial and less costly to have the just-in-time delivery, to have the supplier, in effect, almost stocking the shelves, and no requirement to store the products at either place; either in a warehouse or at the distribution center, the package 6 store.

Admiral KAVANAUGH. May I address that? Remember, Congressman Pickett, the cost for vendors to touch that stuff and put it in all goes into the cost of the product. Then he adds his 5 percent on top. So, all of those costs are hidden.

If I take the cost of the cost of the liquor vendor and add it all in, I have to pass that cost on because I have to be a businessman and I have got to price it.

Mr. PICKETT. Are you suggesting that he doesn't care about what the cost of the product is to his customer? I hope that is not the case. Is it, General Beale?

Mr. SISISKY. That's what he just said.

General BEALE. No, sir, we care a lot, but the issue is this for the commissaries. Prior to consolidation, we had over \$110 million more inventory. It fluctuates from month-to-month. It has been as high as \$150 million lower than what we inherited on day one.

It is about \$110 million right now principally because of problems in Japan with the earthquake and the floods in Europe. We have had to put a little bit more inventory build-up into overseas to accommodate, but that will come down again.

The decision was based on the fact that we knew that we had to make every effort to drive the cost of the system down. In our case, had we done what the services generally did pre-DeCA, and bought inventory in great quantities to put in warehouses, we would be talking about a much higher appropriated burden on the taxpayer than we are today.

In fact, without question, we are always up-front about that. We recognize that, in fact, the FDS system creates a little bit more of a cost to the patron in the cost of the product.

Mr. PICKETT. Is that more than what you would have to pay if you did it?

General BEALE. Yes, sir, by gaining the efficiencies that we have and by bringing the leverage of four independent grocery systems together into one, in the first year that we calculated patron savings, we were a percentage point higher than what the services were able to deliver when they had their own distribution systems. Jack is absolutely right, but we have got a little bit more margin to play with in there, in essence, selling at cost plus 5 percent, where the exchanges across the board generally have to average about cost plus 21 in order to pay all of their expenses and make their expected levels of contribution to MWR. In this case, it is probably more advantageous to the patron to do exactly what they are doing.

Mr. PICKETT. How do you know, General Beale, I know you are an expert in distribution, but how do you know that without looking at the numbers?

General BEALE. Know what, sir?

Mr. PICKETT. Know which was cheaper; to buy through distributors or to inventory yourself and distribute it?

General BEALE. In every case that we have looked at within DeCA, the frequent delivery carries a bit of an up-charge because, in essence, someone has to pay the distributor.

Mr. PICKETT. I understand that.

General BEALE. Either the company pays the distributor or, in the case of the exchanges because they are the distributor, the patron pays the distributor in the basic cost of the merchandise.

Mr. PICKETT. If the distributor does it for less than it costs you to do it, then it is a bargain, isn't it?

General BEALE. Absolutely, and that's what we are finding. That's exactly what we are finding in the case of the distribution network that we use. It is normally, generally more advantageous to the government, the patrons, and the system for them to do it because they can do it cheaper than we can do it with appropriated labor.

Mr. PICKETT. The follow-up question has to do with Alaska and Hawaii where you are now operating, that you are purchasing the alcoholic beverages through the distributors. Is that correct?

General SWARTS. That's correct, sir. It has been that way for a number of years. That has been a legislative provision that I am aware of for at least 3, 4, or 5 years, and maybe even longer than that, Mr. Pickett.

Mr. PICKETT. Are they the only two jurisdictions where you are doing that now?

General SWARTS. Yes, sir.

Mr. PICKETT. Does that pose any special problems for your operation?

General SWARTS. Sir, it causes us to handle those two jurisdictions differently than we would otherwise. It is a given that we will purchase through the distributor as opposed to looking at it from a business decision. Other than that, there is no appreciable difference.

Mr. PICKETT. Thank you. Thank you, Mr. Chairman.

Mr. MCHUGH. I thank the gentleman. Next is the gentleman who has been very patient. He is the chairman of the Readiness Subcommittee, the gentleman from Virginia, Mr. Bateman.

Mr. BATEMAN. Thank you very much, Mr. Chairman.

Let me welcome back the witness panel before our Panel. I apologize for having been absent so much. I have been at the markup for the Clean Water Act which has consumed most of my attention for the last 2½ days.

I don't know what has been asked before I got here. I am just going to ask one specific question to which any of the panel witnesses might respond as they see fit. And, that is, if it hasn't already been covered.

From time-to-time you hear it suggested that there ought to be uniform prices. That the same article ought to cost the same in all of the systems. Does anybody want to comment on whether or not that is a feasible or a desirable situation?

Admiral KAVANAUGH. Let me start, and then I can get the commissaries out of the way and the other gentlemen can state their understanding and positions.

I had an interesting experience not too long ago with some auditors from the Department's Office of the Inspector General who were doing an audit on DeCA pricing. They came back with a finding that said that not in every case was DeCA receiving the lowest price. I said, you are absolutely right and we know that.

They said, well, the law and tradition dictate that the Government always gets the lowest price. I said, in terms of contract law, you are mistaken. In essence, the situation is that the Government always receives the lowest price under the same general terms and conditions of the contract.

Here is the way it would work between the commissaries and the exchanges. As was pointed out earlier by both Admiral Kavanaugh and General Swarts in terms of their pricing, they have targeted specific lines downtown in terms of the competitive aspects of the business.

By law, we are restricted to sell at cost, recoup the cost, and charge the 5 percent that goes into the surcharge that offsets a portion of our total operating costs. Let me give you a clear example.

Also, in answer to an earlier question that was raised about the ability of the exchanges to actually run lost leaders and sell below cost. Obviously, we are not permitted to do that. To give you a classic example, there are probably 150 lines in the health and beauty aids area at the present time where the exchange pricing beats the commissary pricing.

I wish it were not so but, in essence, here are the market dynamics. I will give you one particular example by unit cost that is no longer marketed in that particular size at that particular price, but the principle remains the same.

The unit cost, and it is one of the leading health and beauty aid sellers in both the military and commercial markets. The unit cost from the manufacturer was between a range of \$4.44 per unit on the low end and \$4.84 per unit on the high end.

The advantage that the exchanges have over DeCA is that, on occasion, they are able to take advantage of advanced buys and truckload quantities that will allow them to buy in on the lower end of the spectrum.

DeCA, on the other hand, using frequent delivery in the continental United States, unless we are to engage in a truckload sale, for example, at Langley Air Force Base where we would actually pull the van in the parking lot on Saturday and sell off the back of the truck, DeCA would be buying in on the high end.

Normally the exchanges, again getting back to the cost plus 21 formula, are going to be marking up most of their products at a price level that is above the commissaries because basically we are selling at cost.

In the case of this particular item, the exchanges could buy it at \$4.44 a unit. I have seen that item in the past priced as low as \$3.60 in both the Army-Air Force exchange outlets and the Navy exchange outlets.

My price, \$4.84 with the 4.2 percent frequent delivery up-charge was actually \$5.06 to the patron at the shelf. The reason I leave those items in the commissary is mainly for convenience shopping. In fact, for convenience, there are a number of patrons who are willing to pay more for that item at the commissary than if they went over to the PX which is the exact same reason why so many sailors at Pearl Harbor buy their tobacco products at the exchange for \$3 or \$4 dollars more a carton than what we perhaps might be selling them for in the commissary.

We leave those products in for the convenience of the patron and, on occasion, the manufacturers will offer vendor price reductions or rebates that allow us to drop the price considerably low, below the \$4.84 that we used to pay.

In essence, when you talk lower price or lowest price in terms of contract law, and protocol, it is basically within the same terms and conditions of the contract. That is where you get some discrepancies. Of course, with the exchanges, and I will let them talk to it, you get all of the other dynamics of variable pricing, which we don't have.

General SWARTS. Mr. Bateman, I might add to that, we do, in fact, have a standard pricing policy. Every item that we have in our system has a standard price built into our system. Then we build the variable prices on basically two kinds of programs. One, as I mentioned earlier, is our 250 image items that we survey routinely.

Two we have another program that is fundamentally a best price program. If we have a customer challenge, our customer says we can buy item A at a local store for this amount of money, then we change the price only in that location for that particular item as well.

While we have a standard pricing policy that you can go into the store and buy a tube of toothpaste at the same price all over the world, in theory, but because that tube of toothpaste is probably one of the image items, in fact it will not be the same price in every store. The maximum price will be standard throughout the whole system.

Mr. BATEMAN. Admiral Kavanaugh, do you have any observations?

Admiral KAVANAUGH. No, sir. I spoke quite a bit about that earlier on the pricing aspect, but we price to the outside. A lot of our prices are the same on the things we buy the same. We buy a lot of different items. That is one of the benefits of having two or three exchange systems; especially in a place like Hawaii or Guam where they go to each exchange.

They wander around. They like to go to AAFES one day and to the NEX the next day. They run out to the MCX the next day. It is just generic to people to go out and try to shop at different places.

Now, the commissary is different. My wife always goes to the commissary because she is paying the same basic thing. I sneak into Langley at night in my car to buy things sometimes, just to go out there.

Mr. BATEMAN. Not in uniform, I'm sure.

Admiral KAVANAUGH. No, but my license plate gives me away.

Mr. BATEMAN. I didn't mean to be plowing the furrow that has already been plowed. Let me ask one other question which, hopefully, won't take a lot of your time to respond to.

Transportation costs are a significant factor in everyone's cost of doing business. In your operations, give me any observations you may have with reference to the charges imposed upon you or surcharges imposed upon you by the Military Sealift Command [MSC] to get your goods from the continental United States to where they are going to be marketed.

General BEALE. Sir, the surcharge for us is not an issue, in terms of the MSC or the Military Traffic Management Command [MTMC] operating costs. The issue is the rates established by Military Sealift Command to ensure that U.S. cargo or U.S. troops overseas are shipped under the Jones Act of 1904 on U.S.-flag carriers.

U.S.-flag carriers normally have higher rates than foreign flag carriers. The surcharge aspect of Military Sealift Command in terms of their overhead or Military Traffic Management Command is relatively small and, in fact, insignificant to us in terms of the overall cost of shipping.

What drives the shipping up for DeCA and for the exchanges is the fact that we are tied to published rates by MSC that in fact, are there to ensure that the United States has a sufficient container ship capability for movement of cargo; particularly military contingencies around the world.

Mr. BATEMAN. As the chairman of the Merchant Marine Panel of the committee, I am aware of those aspects of it. I would like to have any data any of you who are affected can furnish us with respect to what you pay above and beyond, or what may be necessary as a higher price, because of the cargo preference implications of this in terms of a surcharge to cover some other element of the Department of Defense and their operating expenses, or their headquarters and administrative costs, which may or may not be passed on to you as opposed to absorbed elsewhere.

Obviously, the costs have to be paid. I would like to look at the data just to see if it is being paid out of the right pocket.

General SWARTS. Mr. Bateman, we continually look at that. In fact, we continually dialogue with the Traffic Management Command and the Military Sealift Command. In fact, we have instituted some experiments with them where, instead of using published rates, we actually go out and compete for container service.

It is still under the auspices of the Traffic Management Command and the MSC. We found competition among U.S.-flag carriers to be quite beneficial. Yes, sir, there is a charge to operate the MSC. If the MSC was not performing that service, then we would have to pick up that service ourselves. We have never looked at that.

General BEALE. Sir, I can tell you that we have done something similar with the Defense Logistics Agency [DLA] where, in essence, we are assuming functions that DLA used to provide for the commissary service because we were able to do it cheaper in-house.

In the case of our reviews with the Military Sealift Command and the Military Traffic Management Command, we have yet to prove to our satisfaction that we could perform those functions cheaper in-house than what they are currently doing.

Mr. BATEMAN. You have looked at it, but you haven't found that you needed to make the change.

General BEALE. Yes, sir.

Admiral KAVANAUGH. If I may, we have also looked at it. That one issue, for any new members of the Panel, is an appropriated fund issue. Just because we are paying more, the sailors are not paying that. They are appropriated funds. Those are being squeezed, so, we are constantly looking at ways of doing a better job on the shipping overseas.

Mr. BATEMAN. Thank you very much, Mr. Chairman.

Mr. MCHUGH. I thank the gentleman. Let me just quickly note in regard to General Beale's comments where he candidly admitted it was his own position and not that of the Department, vis-a-vis the Mattress Decision.

My understanding is that last year Ms. Beacraft of your office indicated before a similar hearing such as this, that at that time, in 1994, there was a package of legislative initiatives being worked through the Pentagon requesting changes to law.

I would assume, or at least theorize, that perhaps the Mattress Decision was to be a part of that. We have never seen that package. Obviously, the Mattress Decision caused some interest here. I am sure there are other things that the Department would be interested in, as well as the various service agencies. And we are very interested in seeing that, Mr. Secretary.

Mr. PANG. Mr. Chairman, I have just been handed a note by Ms. Beacraft. She says that we are looking at several legislative proposals which we hope to forward later this year. In listening to this discussion, and quite frankly having been on the job for about 6 months, it was very good for me just listening to the discussion.

If there are any legislative impediments to better business, then we ought to look at those impediments and report them to you. There was a discussion about a Comp-Gen ruling. Those Comp-Gen rulings normally are founded on some provision of law.

Mr. MCHUGH. We need to change the law.

Mr. SISISKY. Don't wait too long to send that to us.

Mr. BATEMAN. Mr. Chairman, I would just like to make this comment.

Mr. MCHUGH. Certainly.

Mr. BATEMAN. The Secretary is absolutely correct, but you who deal with the implications, the effect of various statutory requirements, are the people who ought to know and be most sensitive to their adverse implications.

We can't do much about it if we don't know anything about it. So, we need to get the signal from you that we can, at least, evaluate the public policy tradeoff as to whether the additional cost is justified. If it is not justified, then we can change the law.

Mr. PANG. You know, Mr. Bateman, this is something that we will look into as soon as we get back.

Mr. SISISKY. Mr. Chairman, General Beale gets a little parochial here. I think I have to do it because it does affect the committee.

Currently, we are paying bills and you said we are up-to-date in 98 percent. I know the problems that you have had in Hopewell, VA, and in San Antonio, TX.

The question really is in two parts. They wanted to move it to another place. I think we have it on hold for a year. I would like for you to comment on how this would affect you. Basically, why do you need two sites to pay your bills?

General BEALE. When DeCA was first established, particularly given the fact that we were going from four commissary systems that spanned four time zones as well as the Pacific in one direction and the Atlantic and Europe in the other direction, it was determined that it would probably be feasible to establish two bill paying sites. That was the general rationale.

What we have learned over the last couple of years is with delivery ticket invoicing, with electronic data interchange, and electronic transfer of funds, we really only need one. Now, the bill paying function, of course, was capitalized from DeCA, the Defense Finance and Accounting Service, October 1 of last year.

The residual of the DeCA bill payers still remained at the Kelly Air Force Base in San Antonio and at the Crossing Shopping Center in Hopewell. At one time, as you will recall, the decision had been made by DEFAS to move all DeCA bill paying to a regional

bill paying site at either Columbus or Newark, OH. Then a decision was made to place it at Pensacola, FL, at the Naval Air Station.

With the different shifts in force structure that have taken place under BRAC 1995 deliberations, there is really no more room at the inn in Pensacola. The Navy has notified DEFAS. Now the matter is under reconsideration by DEFAS.

Received along with Dr. Hamre, the Department's Comptroller, yesterday, an update briefing, I specifically asked the same questions that you have posed to me this morning. Basically, I am under the understanding that the entire DeCA bill paying process is on hold for subsequent review.

In fact, Dr. Hamre mentioned to me yesterday, in a semi-open forum so that folks that were at least in the first three rows could hear, that in terms of reinventing Government, that DeCA bill paying, because it so closely mirrored commercial practices, was one that we probably ought to explore contracting out to see if DeCA could find a financial accounting firm in the civilian sector that could pay bills cheaper than what we are paying in terms of reimbursement to DEFAS employees. That is pretty much up-to-date as of yesterday.

Mr. SISISKY. Thank you very much.

Mr. MCHUGH. I thank the gentleman.

We have a defense supplemental appropriation. There might be one or two votes for that bill here on this Panel.

So, we have to go over to the floor. We want to thank the Secretary and the distinguished members of the Panel for being here. We will be submitting written questions in addition to those and invite other members to join us in that effort. We look forward to those responses.

[The following questions were submitted for the record:]

Army and Air Force Exchange Service Input to DoD

With regard to the drawdown in Europe:

1. What is the impact on exchange and MWR operations?

Europe has been the most significant part of the force reduction challenge that AAFES has faced for the past 5 years. Over this period Army and Air Force strengths in Europe dropped 65% bringing AAFES' European sales and earnings down 44% and 80% respectively. Not only do our earnings in Europe suffer from the inherent difficulties of a massive downsizing; they also reflect our efforts to keep high customer service levels for those soldiers, airmen and their families left behind to wind down closing installations.

2. Is there a need for increased appropriated fund support to supplement a declining financial base which may no longer be self sustaining?

The appropriated funds historically authorized exchanges, while small relative to operating costs (less than 2 cents of a customers dollar), have been vital to maintaining the high level of the exchange benefit for the soldier and airman. Full funding of authorized APF support will be increasingly important in the future, particularly overseas, as smaller forces reduce economies of scale.

Provided the exchanges are fully supported in the currently authorized APF categories, AAFES sees no ongoing need for additional APF support to meet the needs of operations, once the special circumstances of the drawdown period itself have passed. However, there were over \$130 Million in extraordinary costs from downsizing European operations that could be offset with a "one time" special appropriation so they won't detract from the future exchange benefit. These costs include write offs of exchange facilities built with AAFES funds, excess distribution expenses, cost to clear excess inventories and foreign national employee separation (severance) pay directly resulting from closing European operations.

3. Is the weak dollar overseas having an impact on the effectiveness and profitability of MWR programs?

The weaker dollar has put significant strain on earnings due to higher personnel cost for local national employees, local contractors and other foreign procured services. The foreign currencies which we use the most are the Yen and D Mark. The Yen has risen steadily against the dollar since 1990 and is now 40% stronger. The D Mark has been more stable, but has gained 15% against the dollar since 1993 and is impacting current earnings more than the Yen due to the higher volume of D Mark requirements. As a result operations in PACRIM continue to perform well. Earnings in Europe are down due to the less favorable exchange rates as well as costs associated with the draw down. While we estimate the weak dollar will reduce AAFES earnings for 1995 by \$23 million, it has not lowered the level of service we provide our customer.

Residual Value:

4. Please describe the experience in receiving residual value funding for the disposition of facilities overseas.

There are two types of residual value payments in the European Theater. One is monetary compensation (cash payments), and the second is Payment-In-Kind (PIK). To date, AAFES has not received any residual value payments. However, the AAFES shopping center for the Wuerzburg Military Community was included in PIK Package 4 approved by the Secretary Of Defense and presented to the German government in July 1995.

AAFES Capital Investments in the European theater were acquired at a cost of \$112.8 M. The Current Value of AAFES vacated investments to be used by the negotiator as the United States starting position is \$67.4 M.

BRAC FUNDING

5. How have you fared in gaining BRAC funding for expansion of exchanges at bases that are expanding due to realignment and base closure?

AAFES has received minimal BRAC funding for the expansion of exchanges to meet realignments. To date, we have written off \$37 Million in assets left at BRAC installations and received \$10 million in BRAC construction funding. Another \$600K in relocation (transportation) funds has also been received.

CONSOLIDATED OPERATIONS

6. There are all ready a number of bases where there are combined PX and commissary operations. There is the NEXMART, the CX Mart, the BX Mart, the Costanzo model and the shopette plus. Would you please describe these operations and how are they doing?

CXMART.....There is only one AAFES "CX" in existence, at Robinson Barracks in Stuttgart, Germany. AAFES operates the facility. DeCA consigns their inventory to AAFES and it is sold at the DeCA price of cost plus 5%. In addition, AAFES sells certain retail categories at normal AAFES sell prices. Expenses for the facility are shared between AAFES and DeCA at the ratio of sales at cost. DeCA pays a 4% management fee to AAFES. The AAFES bottom line in the facility is reasonable after DeCA pays their pro-rata share.

BXMART.....a BXmart is an AAFES operated (or other exchange service operated) grocery store with little if any appropriated fund support. There are currently two in operation, Ft Worth Joint Reserve Base (formerly Carswell AFB) and Homestead Air Reserve Base. Currently, a BXmart is on a realigned installation where the DeCA commissary has closed due to the loss of appropriated fund support. The building and fixed assets are transferred to AAFES at no cost and AAFES buys the existing inventory from DeCA at cost. AAFES sells all edible items (including pet food) at cost plus 5% to equal the previous commissary pricing of cost plus 5% surcharge. All other non-edible items normally stocked in a DeCA commissary are sold at normal AAFES markup/price. AAFES also adds additional non-commissary categories at normal AAFES markup to help make the facility financially viable. These additional categories include: At Carswell; beer, wine, greeting cards, stationery, traffic appliances, magazines and paperback books, kitchen linens, gardening accessories, small hardware items, etc..... At Homestead; the additional categories are much more like main store departments since it is a combined main store/grocery store.

The Ft. Worth BXmart has been very well received by customers, both reservists and retirees. Financially, the BXmart has operated slightly above break even before general and administrative overhead expenses are applied. The overall exchange which includes the Main Store, Shoppette/Four Seasons, Class Six and food activities has maintained financial viability.

The Homestead BXmart was a tremendous hit with customers who had been without either commissary or exchange support for almost two years. The financial viability of this BXmart will be determined after a full year of operation.

COSTANZO MODEL.....This concept is being tested at Aschaffenburg, Germany because it was not economically feasible to operate both a commissary and exchange. AAFES closed the exchange facility and DeCA kept the commissary open. AAFES supplies certain retail categories like alcoholic beverages and stationery to the commissary to be sold at the AAFES sell prices. DeCA pays AAFES for the product at the AAFES sell price and AAFES pays DeCA a negotiated % to cover operating costs/surcharge (around 16%). It is called the Costanzo model because the concept was first tested by the Navy Exchange and DeCA at Costanzo Italy in 1994.

SHOPPETTE PLUS....the shoppette plus concept is being tested by AAFES and DeCA at Giebelstadt, Germany. This concept also replaces small marginal facilities but DeCA closes the commissary and the AAFES shoppette expands the grocery stock assortment with the top selling 100 commissary items at a 5% markup. The commissary items are supplied to AAFES by DeCA Europe. The local community is involved in the selection of the 100 items. This concept has not been well received by customers. The limited assortment has prompted them to request the small commissary be reopened.

Investment Security

8. What procedures are in place to ensure that the funds invested by your entities are safe and secure?

In accordance with DOD Instruction 7000.12, funds within AAFES are not accumulated for investment purposes (i.e. interest income). AAFES investments are established to fund the Workers' Compensation Program and Local National Separation Pay. Currently AAFES' funds total \$67.6M and follow the guidance of paragraph J.2.b.7(d) of DOD 7000.12 with respect to obligations of the Federal Government, guaranteed to principal and interest by the U.S. Government or obligations issued by U.S. Government-sponsored enterprises.

The investments for the workers' compensation program total \$32.6M and consist of obligations of the U.S. Government and one government-sponsored enterprise (\$5.8M FHLB). They are pledged to the U.S. Department of Labor, Office of Workers' Compensation Programs, Division of Longshoreman and Harbor Workers' Compensation (OWCP/DLHWC) in accordance with U.S. Treasury Circular 154. They are safe kept with the Federal Reserve Bank of Dallas under AAFES CBI #311816695 and cannot be moved without the release authorization of (OWCP/DLHWC).

The investments for the local national separation program total \$35M and consist of both obligations of the U.S. Government and U.S. Government-sponsored enterprises. They are safe kept in our safe keeping account with Nationsbank of Texas. There no restrictions to this account within AAFES. See attached latest listing 08/31/95.

Procedures for purchasing U.S. Government securities and U.S. Government-sponsored enterprise are recorded in AAFES Cash Management Policies dated 16 June 1993. They include the following points.

---Purchase on the open market through competitive bids on the types on instruments available for investments.

---Securities are placed for safekeeping in the FRB of Dallas for the OWCP/DLHWC or in AAFES' safekeeping account at NationsBank of Texas N.A. Dallas, TX for general investment purpose.

---Securities are transferred to our custodial account. Upon receipt, the custodial bank will transfer funds to the seller. The securities will then be transferred from the custodial account to the Federal Reserve Bank pledged to OWCP/DLHWC account or to AAFES' safekeeping account at NationsBank. With respect to the FRB account, we receive telephonic confirmation that the pledged securities have been received followed by a copy of Acknowledgement of Deposit from the FRB in Dallas. In the case of securities delivered to our safekeeping account, a written receipt from NationsBank must be received within 5 working days. Both NationsBank and the FRB in Dallas provide a monthly report reaffirming securities on record.

---Only the Chief of Funds Management and three individuals are authorized to move funds. On separate agreements with each brokerage firms and financial institutions, those same individuals are authorized to purchase government/government-sponsored securities. Concurrence with the CFO is sought prior to the actual purchase of the securities.

The above investments and procedures are routinely subjected to outside audits annually, the last one being performed by Ernst & Young for the fiscal period ending 24 January 1995. They are also subjected to internal audits. The last internal audit was conducted in May 1994 and one is currently in process as of this writing.

State Taxation

The Puerto Rico legislature has imposed a tax on alcoholic beverages sold on military bases there. What is DoD doing to fight this initiative, and are there other proposals being made by the States to tax the military resale entities?

The Commonwealth of Puerto Rico initially attempted in 1994 to restrict the volume of non-taxed alcohol entering the Commonwealth by imposing a tax on individuals who brought tax free liquor into the state. Although supposedly written to impose the tax on anyone who bought non commonwealth tax paid alcohol in any facility, when faced with legal objections from the US military the provision was limited to curtailing the sale of tax free alcohol by stores operated by the Puerto Rico national guard.

As a result of the legislative initiative, the guard no longer enjoys the privilege of purchase or sale of non tax paid alcohol and thirteen of their sixteen locations have been closed. The remaining three sell only tax paid product.

The US military has monitored the actions of the commonwealth legislature and taken affirmative steps to ensure that the tax exempt status of federal agencies and instrumentalities is not threatened. With the Navy command at Roosevelt Roads in the lead, actions have been taken to ensure that all necessary limits on purchase of alcohol are enforced and that all patrons are aware of the local limits on possession of non tax paid alcohol. The military representatives have met with the commonwealth tax officials to present the military position and have coordinated potential responses with the United States Attorneys office in Puerto Rico, should the

commonwealth attempt to undertake any actions to impede the federal functions.

We are not aware of any other current initiatives by state or local entities to tax the military resale activities directly. The only recent proposals in that regard were surfaced in the House Budget Committee and were quickly quashed. Federal statutes require the payment of state motor fuel taxes on gasoline sold on military installations and other state environmental fees and charges are assessed on military installations, as well as the state sales taxes on concessionaires doing business on federal properties.

While there are no instances where states are seeking to directly tax the federal activities, there are several states in which state taxes on producers, distributors or others are being passed on to the military as indirect costs. For example, there are nine states in which the state liquor excise tax is imposed on the introduction or distribution of alcoholic beverages in the state and that cost is included in the cost of goods provided the exchanges. There are other instances where application of gross receipts taxes on suppliers results in a tax incidence being passed on to the military purchaser and, by artful legislative drafting, two states have incorporated special sales taxes on motor fuel products into the state motor fuel tax provisions to enable assessment on sales to the military.

Be assured that the military is monitoring the actions in Puerto Rico closely and taking every step to ensure the continued viability of the non tax paid alcohol sales program. Sales in the military Class Six stores have not declined. The Department of Defense Tax Policy and Advisory Committee has placed the Puerto Rico tax question on its agenda and consults with the Department of Justice on all such attempts by states to tax, or to regulate, the activities of the federal government.

Deployments

10. Would each of the resale commanders describe their system's role in mobilization for war or other contingencies? What has been the experience and what

needs to be done to improve the procedures for assisting deployments?

Since the first exchanges were established in 1895, the exchanges have served side-by-side with America's fighting men and women in the field as well as on post, in times of peace and war. Our role starts with gearing up at home installations whenever the soldier or airman prepares to deploy and carries through to working with theater commanders and staff in the field. The military mission, situation and doctrine will determine the type and level of exchange service to be provided which will be backed up by AAFES full logistical complex which supports all our operations every day. Our experience, ranging from the conflict in the Persian Gulf to peace keeping in Haiti, humanitarian support in Somalia and to forces fighting fires in the Pacific Northwest, has proven the importance of exchange support wherever forces deploy. Its a success story we are proud of.

CONSTRUCTION VALIDATION

11. Please describe your methods of validating the scope of construction projects. What needs to be done to improve the procedures? How does your program benefit from validation studies that are available from commercial consultants?

A three-step method is used to determine the size of the project:

- The number of customers within a 40 mile radius of an Army or Air Force location is determined. This radius is reduced when there are two or more locations whose normal 40 mile radii overlap.

- The overall sales potential for each business category is created using both multi-linear regression and an artificial intelligence (AI) neural net program, which in turn leads to a sales estimate. Competition, city size, commissary sales, post/base mission changes, sales per square foot, etc. are also considered when determining sales estimates.

- Once sales and earning estimates have been made, the final step is to determine the size of the facility. For the majority of our businesses, we have standard facility sizes which are based on achieving a given sales level. The exception to this is within our main stores, which are sized based on a dynamic store sizing model.

Commercial consultants are currently used to validate concepts within many of our businesses. We currently utilize consultants for the following categories; Food Concepts and Decor, New Services (i.e. hair care, dry cleaning, etc.), Parking and traffic studies, and merchandise preparation area studies for all retail. Use of these studies have allowed us to validate our sizing needs and design our floor space in the most efficient manner.

Financial Performance

12. Please describe the trends in sales and earnings and where do you see the systems going in their financial performance?

With continued decreases near term, we expect customer strength will be stable in 1997 and beyond. Sales and earnings will accordingly decrease this year and then experience slow to moderate growth in real (constant dollar) terms outbound through the year 2000.

Currency Fluctuations Overseas

13. Please describe the impact of the adverse currency fluctuations overseas and how you are reacting? Particularly in Japan -- are you benefiting from the Japanese program to pay for foreign national employees?

Adverse currency fluctuations overseas impact all foreign currency transactions. AAFES largest foreign currency requirement is for local national payrolls, followed by construction and other services. We are actively involved in short term hedging, but this does not offset long-term negative trends. Due to status of forces agreements and availability of a work force, we don't have much flexibility with payroll cost. There are ongoing efforts to make operations more efficient and profitable, but this

would take place regardless of the currency situation. One of the efforts includes moving overhead functions from overseas to CONUS which will reduce cost and exposure to currency fluctuations. Sales can be positively impacted, since a service member's dollar will go further at an AAFES operation than on the local economy.

AAFES does receive Basic Wage Offset funds from the Government of Japan (GOJ-BWO funds). These funds can only be used for a restricted set of expenditures that basically assure the funds benefit servicemen stationed in Japan (including Okinawa.) Although the GOJ funds are a significant assistance in providing the exchange benefit in Japan, local national personnel costs must be incurred to obtain the funds. As the Yen strengthens against the dollar, GOJ funds offset only the Yen personnel cost impact - not the increases to other Yen paid expenses.

Technology

14. Please describe your plans for investing in technology and how will this technology enable cooperation among the resale entities and economies in your operations?

Major investments in technology will be directed toward implementing "open architecture" "in-store" systems and reengineering legacy systems using client/server architectures which provide immediate access to the information needed by a modern retailer. AAFES will employ a variety of strategies to be more responsive to market demands as we seek faster and better ways to solve business problems.

All enhancements will adhere to the DoD resale communities standards which provide the highest levels of data integrity and data sharing for increased cooperation with our MWR partners and sister exchange services. AAFES will also use new and improved tools to enhance systems development effectiveness, increase productivity, and speed up system delivery time frames.

Savings to Patrons

30. What are your most recent findings of savings to patrons? Would one savings survey for all of the DoD resale entities be useful so that everyone is comparing apples to apples?

AAFES 1995 Annual Retail Price Survey showed overall savings to our customer of 19.7%. While a single overall survey could provide for comparison, AAFES has no real use for the information. Our pricing concerns involve generating earnings and providing customers savings which we have to do in competition with the retail market place wherever we operate. There are not that many locations where our sister exchange services compete with AAFES and the Army and Air Force MWR businesses by definition do not directly compete. A single cross the board survey, given the different businesses and operating/pricing mechanisms involved, would be expensive relative to its results.

CARSWELL AFB TEST

The Panel has learned of a study conducted in DOD regarding the potential for savings if commissaries and PXs were consolidated. This study shows that within 4 years, savings of \$477 million per year would be realized from the FY 1966 baseline. Have you seen this study and could you share your thoughts on it?

There has been no "study" commissioned on commissary and exchange consolidation. An informal discussion of the possibility was held between AAFES and DeCA and the results were written in a "what if" type of fact paper. No validation of either the assumptions or financial projections has been accomplished.

Competitive Analysis

27. What information does DeCA, AAFES and NEXCOM receive on those major grocery, discount and warehouse club outlets with whom they compete? Is there consistent monitoring of their stores performance against the military stores and how is this information used to ensure customer needs are being met?

AAFES closely tracks and monitors its primary competitors and the industry to stay abreast of current trends in a number of ways. We hold memberships in the major trade organizations such as the National Retail Federation, the International Mass Retailers Association and the National Association of Convenience Stores. Through these memberships, AAFES staff members stay abreast of the state of the industry and cross-feed with contemporaries in retailing. We also use the numerous publications, studies and research produced by these organizations.

AAFES has an ongoing relationship with Management Horizons (a consulting division of Price Waterhouse) and subscribes to its Retail Intelligence System, a proprietary industry tracking/analysis program. The subscription includes conferences, baseline reports, critical issues reports, financial performance reviews, monthly newsletters, Quick Facts service and access to its staff of experts.

AAFES is also a member of The Conference Board (a high level business/economic trend analysis organization) and subscribe to Standard & Poor's Retailing Industry Survey and the Management Ventures, Inc. "Selling National Accounts Monthly" which focuses on our discount store and warehouse club competitors. We also receive and study all CS First Boston research reports on individual retail companies.

Other sources of competitive information include general business and trade publications, electronic databases which track industry/competitor developments and annual reports/ 10-Ks to benchmark competitor results.

Relevant information from all of these sources is disseminated/circulated on a routine basis to our strategic business groups and is then used as the basis for developing the situational analysis which is the prelude to and is incorporated in the AAFES strategic planning process.

DRAWDOWN

Mr. Spence: With regard to the drawdown in Europe, what is the impact on exchange and MWR operations?

ADM Kavanaugh: There is no impact on Navy Exchange operations as a result of the drawdown in Europe. The Navy reduction in Europe is not significant enough to impact sales or profits.

Mr. Spence: With regard to the drawdown in Europe, is there a need for increased appropriated fund support to supplement a declining financial base which may no longer be self-sustaining?

ADM Kavanaugh: No, this is not applicable to Navy Exchange operations.

Mr. Spence: With regard to the drawdown in Europe, is the weak dollar overseas having an impact on the effectiveness and profitability of MWR programs?

ADM Kavanaugh: Yes, to a great degree in Europe, and in other markets such as Japan, the fluctuation in currency has significantly increased local national payroll expenses and benefits which directly impact our bottom line.

RESIDUAL VALUE

Mr. Spence: Please describe the experience in receiving residual value funding for the disposition of facilities overseas.

ADM Kavanaugh: To this point in time, we have received no funds for the residual value of closed overseas facilities. The residual values have been written off against then current year non-appropriated fund revenues.

BRAC FUNDING

Mr. Spence: How have you fared in gaining BRAC funding for expansion of exchanges at bases that are expanding due to realignment and base closure?

ADM Kavanaugh: To this point in time, we have received approximately \$10.0M related to BRACON. We are hopeful that future requirements will be funded and that those funds will be passed to NEXCOM.

CONSOLIDATED OPERATIONS

Mr. Spence: There are already a number of bases where there are combined PX and commissary operations. There is the NEXMART, the CX Mart, the BX Mart, the Costanzo model and the shoppette plus. Would you please describe these operations and how are they doing?

ADM Kavanaugh: There are 13 NEXMARTs operated by NEXCOM and one Costanzo model facility operated by DeCA. Both types of operations sell all authorized commissary categories (except cigarettes) at cost plus 5%. Cigarettes are sold at the NEX price. These facilities have proven to be extremely beneficial and successful, particularly at those locations where it would be uneconomical to operate separate exchange and commissary activities.

Information requested on the CX Mart, the BX Mart and the shoppette plus can not be answered by NEXCOM. They are directly related to AAFES and it would be best if presented to them for response.

COMBINING COMMISSARIES AND EXCHANGES

Mr. Spence: The panel has learned that nearly \$380 million could be saved each of the first 3 years from the FY 1996 baseline by consolidating exchanges and commissaries. This apparently is based on extending the Carswell model worldwide. Is this accurate? Does such a study exist, and how can the Panel get a copy of this study?

ADM Kavanaugh: The Navy Exchange System has not participated in a study which supports \$380M in savings.

INVESTMENT SECURITY

Mr. Spence: What procedures are in place to ensure that the funds invested by your entities are safe and secure?

ADM Kavanaugh: NEXCOM has investment policies and procedures which provide guidelines for the management and investment of funds for the Navy Exchange System.

NEXCOM has an Investment Committee consisting of the Commander, Treasurer, Assistant Treasurer, and Controller. The committee is required to meet at least quarterly, to review the performance of the investment portfolio. They are responsible for validating the current investment strategy, overseeing the security of funds, assessing yield optimization, analyzing the mix of authorized investment instruments, ensuring that liquidity is maintained to meet daily cash needs.

NEXCOM investments are made in accordance with mandated objectives of:

Safety

Liquidity

Yield

NEXCOM follows all regulations and guidelines set forth in the following instructions:

Treasury Circular 176

DoD Instruction 7000.12

NEXCOM Internal Instruction 7000.4C

Criteria for Investment Types

~ CDs up to \$100,000 must be insured by FDIC or NCUA.

~ CDs above \$100,000 must be collateralized with government securities.

~ Financial institution must meet a 4% equity to assets ratio

~ Interest paid monthly on all CDs

~ No more than \$10.0 million with a single institution

~ All Repurchase Agreement transactions are made with primary dealers specified by the Federal Reserve Bank, and are collateral in the amount of 102 percent of market value of the purchased security, plus interest is required. All security collateral is delivered to a third party bank selected by NEXCOM.

NEXCOM operates a centralized cash and investment program for the Navy Exchange program worldwide. The primary goals of the program are to provide a financial resource for operations and to maximize earnings on cash through investments. NEXCOM stresses safety (no derivatives), liquidity and yield in addition to the various government publications which provide guidance to its investment strategy.

STATE TAXATION

Mr. Spence: The Puerto Rico legislature has imposed a tax on alcoholic beverages sold on military bases there. What is DOD doing to fight this initiative, and are there other proposals being made by the States to tax the military resale entities?

ADM Kavanaugh: Our understanding is that the Puerto Rican legislature has proposed that a tax on alcoholic beverages sold on military bases be imposed effective 1 October 1995. We know of no effort to fight this initiative but are working with local authorities to provide alternative measures and to ensure cooperation. We know of no proposals being made by other states to tax the military resale entities.

DEPLOYMENTS

Mr. Spence: Would each of the resale commanders describe their system's role in mobilization for war or other contingencies? What has been the experience and what needs to be done to improve the procedures for assisting in deployments?

ADM Kavanaugh: NEXCOM supports both the Active Duty and the mobilization Ready Reserve components. During Desert Storm, NEXCOM mobilization support of ships stores was accomplished by having \$29 million of appropriated fund support available to purchase and maintain "surge" material requirements. Our proven policies and procedures work equally well in peace or war, and we have effective commercial vendor partnerships in place. We also serve as technical point of contact for operational and support assistance to Ready Reserve forces assigned to ships stores in Fleet hospitals, USNS hospital ships and Expeditionary Logistic Support Forces. In 1994, we supported the activation of the USNS Comfort for Haitian relief efforts and Fleet Hospital units with UN Forces in Croatia. Additionally, the flexibility of the ship store operation has enabled us to deploy a ship store ashore to support in theatre forces in Bahrain.

To ensure we maintain the capability to support both the Active Duty and the mobilization Ready Reserve efforts, we need the continued availability of appropriated funds which are jeopardized by recent efforts to convert the ships stores program to nonappropriated fund support.

CONSTRUCTION VALIDATION

Mr. Spence: Please describe your methods of validating the scope of construction projects. What needs to be done to improve the procedures? How does your program benefit from validation studies that are available from commercial consultants?

ADM Kavanaugh: Construction projects are initiated in conjunction with the local installation commander, the major claimant and NEXCOM. The validation process includes the review of current and projected demographics and the expected sales and financial results. Review and analysis is conducted by facilities, operations and financial managers at each of the activities. Proposed projects with relevant analyses are presented to the MWR/NEX Board of Directors for approval. Those projects requiring approval above the Navy threshold are forwarded to the Department of Defense and, where necessary, to the Congress for final approval. Our internal validation process has proven effective in identifying and prioritizing project needs consistent with requirements and funding programs. Validation studies available from commercial consultants have added little benefit to our program but have added time and cost to the process.

FINANCIAL PERFORMANCE

Mr. Spence: Please describe the trends in sales and earnings and where do you see the systems going in their financial performance?

ADM Kavanaugh: Revenues for the first two months of FY95 were below the same period of FY94 by \$26M, or 9%. Net income for the first two months of FY95 was below the same period of FY94 by \$875K, or 10%. However, sales per active duty service member and net income per active duty service member have risen steadily over the past three years. Sales per capita have increased from \$3,672 in FY92 to \$4,126 in FY94. Net income per capital has increased from \$133 per person in FY92 to \$156 in FY94. We attribute these increases to our successful expense control efforts and continuing improvements to our business processes. We expect that the increase in sales per capita and corresponding net income per capita will continue.

CURRENCY FLUCTUATIONS OVERSEAS

Mr. Spence: Please describe the impact of the adverse currency fluctuations overseas and how are you reacting? Particularly in Japan -- are you benefiting from the Japanese program to pay for foreign national employees?

ADM Kavanaugh: Currently, NEXCOM uses a multi currency vendor account established with American Express. The purpose of this account is to pay vendors in their local currency. The rate of exchange is determined by the spot rate. However, NEXCOM is exploring the possibility of paying vendors and negotiating exchange rates with one of its lead banks.

While the government of Japan is reimbursing NEX Japan for the cost of labor, NEX Japan is not receiving a direct benefit because all reimbursements (including labor) are required to be re-employed in special programs and projects within Japan.

In Europe, NEXs are not reimbursed by the host country for labor expense, therefore, fluctuations in currency can negatively impact NEX profitability.

TECHNOLOGY

Mr. Spence: Please describe your plans for investing in technology and how will this technology enable cooperation among the resale entities and economies in your operations?

ADM Kavanaugh: We are spending \$63.9M over 4 years, FY 93-97, to bring NEX from the 1960s to the 1990s. 45% of our stores have no ADP capability - not even Point-of-Sale scanning registers. Payback is in the \$50M to \$100M per year range. Another key reason for modernizing is that our 1960's vintage systems are dying with no parts support from Honeywell available. These ancient systems are very costly to maintain and experience lots of downtime.

This implementation of technology will result in a heightened level of synergy among the resale entities. The Marine Corps is outsourcing a portion of their technology to us and we have Internet connectivity for mail interchange with AAFES.

ADVERTISING AND COMPETITION

Mr. Spence: What is the DOD policy with regard to advertising and competition with off-base programs?

ADM Kavanaugh: The DoD prepared an instruction, DODINSTR 1015.2, dtd 15 May 1985, which states:

"DOD MWR activities ... must communicate their presence and the availability of the goods and services they offer to as many potential patrons as they can. However, such communication must be restricted, as far as possible, to authorized patrons."

"Mailings of material promoting the sale of products or services are authorized only to patrons who voluntarily have signed up to receive such information. Any mailings containing specific branded products or pricing information are bound by this restriction."

" MWR activities may purchase advertising when authorized in U.S. Armed Forces newspapers and civilian enterprise publications ... produced primarily for distribution on a military reservation or to authorized MWR activity patrons. Information pertaining to the sales of goods and services, including brand names and item prices may be included in such paid advertising".

The DODINSTR 1015.2 was recently revised on 6 January 1995 ... "to allow MWR event advertising in appropriate civilian media when events are open to the public. These events foster good community relations. Examples of MWR events that may be advertised in civilian media include, but are not limited to concerts, athletic programs ..."

EXCHANGE CHAIN OF COMMAND

Mr. Spence: Under the Navy's exchange system, the base exchange officer reports to the base commander. With this chain of command, how do you exercise control over exchange operations?

ADM Kavanaugh: We exercise control over exchange operations through our responsibilities and functions as the "Program Manager" which include staffing and training senior managers as well as the issuance of policies and procedures. NEXCOM also reviews, approves and monitors sales and profit plans for all exchanges and, as a result, produces a consolidated operating statement and balance sheet.

USE OF MILITARY PERSONNEL IN EXCHANGES

Mr. Spence: What is the justification for using Navy personnel in managing PXs?

ADM Kavanaugh: Navy Supply Corps Officers contribute significant management expertise based on their business focused operational experiences and graduate level education (MBAs) and ensure that exchange operations are appropriately supportive of "fleet" requirements and priorities. Additionally, the exchange billets provide necessary sea/shore rotation opportunities in meaningful positions and provide substantial experience and a "fleet perspective" to exchange operations.

NEXCOM FINANCIAL PERFORMANCE

Mr. Spence: Your prepared statement is devoid of any statistics regarding the financial performance of your exchanges. How do sales and earnings from fiscal year 1995 compare to fiscal year 1994 and is the trend downward?

ADM Kavanaugh: Revenues for the first two months of FY95 were below the same period of FY94 by \$26M, or 9% - the same percentage reduction in active duty personnel. Net income for the first two months of FY95 was below the same period of FY94 by \$875K, or 10%. However, sales per active duty service member and net income per active duty service member have risen steadily over the past three years. Sales per capita have increased from \$3,672 in FY92 to \$4,126 in FY94. Net income per capital has increased from \$133 per person in FY92 to \$156 in FY94. We attribute these increases to our successful expense control efforts and continuing improvements to our business processes. We expect that the increase in sales per capita and corresponding net income per capita will continue.

ALCOHOLIC BEVERAGE DISTRIBUTION

Mr. Spence: We have received information that the cost of distributing alcoholic beverages to the exchanges is understated and that this service could be better performed by private sector distributors. Do you include the total cost of distribution in coming to a determination not to use commercial distributors for this purpose?

ADM Kavanaugh: We do not agree that the cost of distributing alcoholic beverages to the exchange is understated. A recent Congressionally mandated study by the certified public accounting firm of Deloitte and Touche reported that "Based on both the quantitative and qualitative analysis conducted during this study, it is our opinion that NEXCOM is procuring distilled spirits in the most cost-effective and efficient method."

CREDIT

Mr. Spence: How much of your internal capital is tied up in extending credit to the military? Has this impeded your ability to purchase inventory or undertake construction?

ADM Kavanaugh: Currently, our NEXCARD receivable balance is \$170M. Our bank borrowings are \$80M. Therefore, we are using \$90M of internally generated funds to finance the NEXCARD receivable. These are approximate numbers and they may vary by +\$5M, daily. We have not curtailed our purchase of inventory in any way nor have we decreased our construction plans as a result of these borrowings.

NAVY PX CONSTRUCTION

Mr. Spence: The DOD report to the Congress on credit shows that NEXCOM will invest about \$10 million per year on capital projects over the next five years. Is this a good rate of investment for an entity with \$2 billion in annual sales? What are the reasons for this poor investment posture?

ADM Kavanaugh: The Price Waterhouse summary clearly indicates the following capital expenditures by year:

1994	\$48M
1995	\$47M
1996	\$69M
1997	\$53M
1998	\$50M

These capital expenditures include funding for our ADP modernization effort described in question #14 which ultimately will significantly improve our profitability and our ability to provide dividends to the Navy MWR program.

OUTPLACEMENT OF CREDIT RISK

Mr. Spence: Why did the Navy choose to outsource the placement of their credit program to a commercial bank and what has been your experience with this decision?

ADM Kavanaugh: We chose to outsource the credit program because our current ADP systems could not support the effort. While NEXCOM owns the receivable, the operations of the NEXCARD program have been outsourced to Citicorp Retail Services (CRS), a wholly-owned subsidiary of Citicorp. CRS performs the issuance of the plastic NEXCARD cards, monthly billing, authorizations, etc.. NEXCOM maintains control of the program by determining who gets the NEXCARD and the amount of credit. CRS is a leader in private label processing, and we have been able to use their expertise to continually improve the NEXCARD program since inception.

Mr. Watts: What could be done to make the exchange system more attractive to your customers? Are there specific actions this Congress can take to improve the attractiveness of shopping in the exchange for our soldiers, sailors, airmen, marines, their families and our retirees? What products and services are currently unavailable due to Congressional "meddling" in the business of running the exchange operations?

ADM Kavanaugh: ASER is a DoD regulation that limits what its exchanges can sell. Historically, changes to this regulation have been approved by the HASC (now the House National Security Committee (HNSC)).

This regulation is outdated and forces Sailors to buy items like furniture, televisions, jewelry, microwave ovens, sporting goods, flatware and bar-b-que grills at higher prices and higher rates of interest when they charge them off base. It also unfairly penalizes domestic manufacturers of items, furniture for example, which cannot be sold in U.S. Exchanges, while foreign made ready-to-assemble (RTA) furniture is authorized for sale.

The Senate has submitted language as part of the FY96 Authorization Bill to rescind all restrictions. HNSC should, at a minimum, allow for conference language that authorizes the DoD to select categories authorized for sale or other restrictions.

RE-IMPLEMENTATION OF CATEGORY MANAGEMENT

Mr. McHugh: What are the goals of the new system contemplated under the draft RFP? To what extent will the system enable DeCA to analyze local competitive sales trends, evaluate promotional information and obtain access to training on industry standard category management?

ADM Kavanaugh: NEXCOM can not answer this question. It directly relates to the Defense Commissary Agency (DeCA) and would be best if presented to them for response.

Mr. McHugh: Are there any plans to extend the hours of operation of the Commissaries?

ADM Kavanaugh: NEXCOM can not answer this question. It directly relates to the Defense Commissary Agency (DeCA) and would be best if presented to them for response.

Mr. McHugh: Does DeCA plan to follow industry practices and make its product movement data available to more than one party? If not, what is the benefit to taxpayers and Commissary customers?

ADM Kavanaugh: NEXCOM can not answer this question. It directly relates to the Defense Commissary Agency (DeCA) and would be best if presented to them for response.

Mr. McHugh: What information does DeCA, AAFES and NEXCOM receive on those major grocery, discount and warehouse club outlets with whom they compete. Is there consistent monitoring of these stores' performance against the military stores and how is this information used to ensure customer needs are being met?

ADM Kavanaugh: NEXCOM reviews many different trade magazines, journals and informational services in an attempt to ensure that its exchanges are comparable to the major commercial retail outlets in order to ensure that our patrons receive the benefit of being able to obtain quality goods and services at a savings. We include these major commercial outlets in our price surveys and we offer to match their prices on "like" advertised items.

Question: Please describe the experience in receiving residual value funding for the disposition of facilities overseas.

BGen Joy: The Marine Corps has had no experience in receiving residual value funding for the disposition of facilities overseas.

Question: How have you fared in gaining BRAC funding for expansion of exchanges at bases that are expanding due to realignment and base closure?

BGen Joy: As of this time, the Marine Corps has not received any BRAC funding. Funding will be required in 1997 to accommodate the realignment of Marine Corps Air Station Miramar. Funds would be used to transfer merchandise, equipment, and personnel to the new location and to make necessary modifications to existing facilities.

Question: What procedures are in place to ensure that the funds invested by your entities are safe and secure?

BGen Joy: The Marine Corps investments are overseen by the Investment Oversight Committee which is chaired by the Fiscal Director of the Marine Corps. All investments are mandated to be placed in either federal government securities or federally insured certificates of deposits at high credit quality financial institutions. The number one goal of the Marine Corps investment portfolio is to ensure the safety of funds. The second and third goals are liquidity and yield, respectively. The investment policy adhered to includes DoD policy, DoN, and USMC policy. All investment transactions are subject to strict internal control procedures and approvals. The investment portfolio is audited for compliance on an annual basis by a public accounting firm and by USMC internal auditors.

Question: Would each of the resale commanders describe their system role in mobilization for war or other contingencies? What has been the experience and what needs to be done to improve the procedures for assisting in deployments?

BGen Joy: The Tactical Field Exchange (TFE) is designed to provide temporary support to military personnel engaged in emergency operations anywhere in the world. Tactical exchanges provide class VI supplies (snacks and personal hygiene supplies) that are sold to the troops while in the field. During exercises this stock assortment list may be increased or decreased based on seasonal requirements or customer demand.

Predeployment phase: During this phase merchandise is shipped from MCX/AAFES or local vendors to a parent exchange. The amount of merchandise required is based on the number of days it will be in operation and the number of personnel using the exchange. The parent exchange also prepares a change fund, operating equipment and supplies, and if necessary a petty cash fund for the tactical exchange. The merchandise is loaded into shipping containers and prepared for shipment to the operational sites. At this point, the tactical field exchange officer (TFEO) assumes accountability for the entire shipment.

Deployment phase: Containers are shipped by the military services to the operational sites. The tactical exchange receives the merchandise, sets up operations, and operates the retail store. Receipts from retail sales are prepared and mailed to the parent exchange. When the military operation is complete, the tactical exchange is disassembled. All unsold merchandise, along with the remaining operating supplies and equipment are reloaded into the shipping containers and shipped by the military service back to the parent exchange or sold to AAFES.

Post deployment phase: This wraps up the MC exchange activity. All merchandise and supplies/equipment are accounted for and returned to stocks. All documentation sales receipts and returns are reconciled. At this time the TFEO is relieved of accountability unless usually large losses must be investigated. A transition plan should be worked by the Military Commands Operations Officer and TFEO to turn over excess inventory to AAFES/DeCA without a break in service to the customer. Finally, complete an after action report.

Regarding improvements needed based on past experience the following applies:

- The parent exchange and the deployable military unit need to coordinate concept of operation plans prior to TFE deployment.
- MWR military personnel to operate the TFE must be identified as soon as the level of support required in the theater of operation is determined.
- Joint service operations should have a clearly identified Joint Task Force (JTF) representative.
- Merchandise inventory planning should be done considering the use of sundry packs.
- TFE warehouse space should be included in any JTF space allocation plan.
- Additional airlift space should be allocated to the TFE.
- TFE's merchandise selection should be 85% snack food type items and 15% personal hygiene.
- TFE should coordinate check cashing privileges with the Marine Corps and other U. S. Armed Forces Disbursing Offices.
- TFE's must be provided Defense Switching Network (DSN) access and Local Area Network (LAN) with parent base and headquarters agency.
- TFE should be assigned a vehicle for transportation.
- Personnel to operate the TFE should arrive in country along with merchandise.

Question: Please describe your methods of validating the scope of construction projects. What needs to be done to improve the procedures? How does your program benefit from validation studies that are available from commercial consultants?

BGen Joy: The Marine Corps uses several methods to validate the scope of proposed exchange projects. The most significant measure of whether or not a scope is reasonable is by an analysis of the sales per square foot in different categories of sales areas. Where an analysis is inconclusive, we have the size validated by an independent agency. We have used commercial consultants for validation studies with mixed results. We have not experienced a significant impact in program benefit due to the use of commercial consultants; however, their recommendations lend credibility and confidence to internal validations.

Question: Please describe the trends in sales and earnings and where do you see the systems going in their financial performance?

BGen Joy: The Marine Corps MWR system has had substantial sales increases in each of the past four years (FY91-FY94). Sales have increased 23.1 percent during this period. Earnings have also increased to support the recreation programs. The increase in earnings from FY91 to FY94 is 13.5 percent.

Sales for the first six months of FY95 show a decline of 7.2 percent when compared to the first six months of FY94. The sales have declined due to two factors, a change in the NAF fiscal year which has eight less days and the decrease of sales on the AAFES Deferred Payment Plan. Earnings are comparable with the same period of FY94 even though sales are down.

The Marine Corps expects continued improvement in sales and earnings. With modernization in electronic point of sales, accounting systems, and other technological areas, the Marine Corps will gain efficiencies to improve customer service and streamline its operations.

Question 13: Please describe the impact of the adverse currency fluctuations overseas and how are you reacting? Particularly in Japan -- are you benefiting from the Japanese program to pay for foreign national employees?

BGen Joy: The Marine Corps has major foreign bases in Japan. European currency fluctuations have had no major impact on our operations. For Japanese bases, the Marine Corps has set up a headquarters yen account that our commands can borrow to fund foreign national payrolls that are reimbursed by BWO (Basic Wage Offset) approximately a week later by the government of Japan. Previously, the commands purchased yen from the local military banking facility and incurred foreign exchange value risk along with costly transaction fees when yen was bought and sold. The new system allows our Japanese commands to borrow in yen and repay the borrowings in yen, thus avoiding foreign currency fluctuations in value versus the dollar. The interest rate structure in Japan is much lower when compared to the United States. The Japanese government just lowered its government discount lending rate to one-half of one percent on September 8, 1995. Borrowings are only initiated for reimbursable BWO payroll or BWO bonuses by the Japanese government. In FY94 the Marine Corps was reimbursed \$13.9 million in BWO funds and is on track to receive \$19.3 million of BWO funds in FY95. BWO was raised from 75 percent reimbursable in FY94 to 100 percent reimbursable in FY95. The recent strength of the dollar versus the yen has relieved some of the costs that are incurred for non-payroll expenditures that are paid in yen.

Question: Please describe your plans for investing in technology and how will this technology enable cooperation among the resale entities and economies in your operations?

BGen Joy: USMC MWR is investing as follows:

1. Migrate our existing COBOL applications that run under a proprietary NCR ITX system to a UNIX platform using MicroFocus CoBol. This migration will provide the Marine Corps with greater flexibility for modernizing our Recreation and Food/Hospitality programs. This project will be completed by third quarter 1996.

2. Work with the Navy Exchange Service Command (NEXCOM) as our outsource provider for ADP processing and support for our retail applications. The outsourcing agreement will allow the Marine Corps to use state-of-art technology, operate form one common database using industry standard UPC's and exchange data establish a Wide Area Network (WAN) between MWRSPACT, Marine Corps commands, and NEXCOM Headquarters. This endeavor will help centralize Marine Corps resale procurement functions, provide better access to the NEXCOM distribution system, and improve system-wide merchandise buying power thereby passing additional savings to our Marine Corps MWR patrons.

Questions For the Record
 April 6, 1995 Hearings on
 The Effect of Force Structure Drawdown
 On Commissaries and Exchanges

Additional questions - AAFES Input to DoD

ALCOHOLIC BEVERAGE DISTRIBUTION #16

We have received information that the cost of distributing alcoholic beverages to the exchanges is understated and that this service could be better performed by private sector distributors. Do you include the total cost of distribution in coming to a determination not to use commercial distributors for this purpose?

AAFES uses "benchmark costs" to represent our internal cost to distribute distilled spirits. If commercial distributors can meet or better that cost we use them otherwise our package stores order from AAFES distribution centers.

AAFES benchmark costs are in no way understated. In fact the accounting firm of Deloitte and Touche LLP, in their report to the Deputy Assistant Secretary of Defense (Personnel Support Families and Education) said "the existing methodology enables AAFES to make the correct economic business decision with respect to selecting the lowest cost channel of distribution." Deloitte and Touch went on to report AAFES' benchmark costs were, if anything, overstated compared to the actual distribution costs they independently calculated.

Deloitte and Touche went on to report that the savings generated from making the correct distribution decisions provided for greater contributions to MWR funds by the exchange services or lower prices to the Soldier, Sailor, Airman and Marine.

DIAMONDS # 17

Are your exchanges in compliance with the Panel's direction with regard to the size of jewelry that is sold in your exchanges?

AAFES processes customer special order purchases of larger (1.0 - 2.0 carat) diamond engagement rings in order to extend AAFES price and quality protection to service members when they make that significant investment. Our high in-house rejection rate on these rings (21%) demonstrates the advantage afforded our junior customers. Display stocks have been placed in selected CONUS stores.

CREDIT #18

How much of your internal capital is tied up in extending credit to the military? Has this impeded your ability to purchase inventory or undertake construction?

AAFES has utilized both internal and external funds to finance the Deferred Payment Program (DPP). As a result of DPP, we went from a position of investing approximately \$320 million to borrowing approximately \$840 million. At the present time, \$565 million from AAPES internal sources are used to finance DPP. The earnings gained from DPP more than compensate for the loss of investment income and could not be replaced. According to the 1994 audit of the DPP program by Ernst and Young, DPP contributed \$51.0 million to the bottom line of AAPES.

AAFES has taken the necessary steps to ensure that it has sufficient capital to operate its business and build for the future. We have not had nor do we foresee any difficulty in providing capital to purchase inventory or undertake construction. We have a credit facility that provides up to \$1 billion in committed funds from eleven major banks. We also have access to \$660 million in uncommitted funds. In addition, AAPES is generating positive cash flow from operations. Combining this available credit with our own internal sources of funds provides more than adequate capital coverage.

In 1994, DOD engaged Price Waterhouse to:

- a. Review AAPES' financial position after the introduction of the Deferred Payment Program (DPP)
- b. Determine and analyze the internal and external sources of funding DPP growth
- c. Assess the level of leverage and risk caused by funding DPP growth
- d. Analyze the feasibility of commercial paper

Price Waterhouse concluded that AAPES was effectively using the financial markets to obtain funding at a competitive interest rate. They concluded that AAPES has a lower degree of risk and leverage than its retail peers and they recommended commercial paper as a viable and prudent source of funding. Very importantly, their review also showed that AAPES had not changed its vendor terms or sacrificed investment in its ongoing business to finance the DPP receivable.

Price Waterhouse's review was a thorough and independent confirmation that AAPES had its house in order and was judiciously financing the expanded DPP program.

NON-FOOD ITEMS IN COMMISSARIES #19

We understand that the addition of non-food items such as batteries, hosiery, pet food, cleaning supplies and health and beauty aids into commissaries is a relatively recent development. Has this detracted from the ability of the exchanges to make money and does it deviate from the commissaries intended purpose?

The sale of non-food items in the commissary is not a recent development. As an example...the commissaries began selling batteries in 1984-85 and after the first year AAFES realized a \$5 million decrease in sales. The reduced sales have not only impacted the AAFES bottom line but also reduced MWR contributions as a direct result.

OVERSEAS CAR SALES #'S 20 AND 21

-The panel has learned that there are changes being contemplated in the overseas car sales program. We have heard from a number of people that these changes could provide a monopoly to one company and inhibit competition. Also, there is concern about the findings of a recent audit of the overseas car sales program.

20-Have the findings of the audit been resolved to your satisfaction?

All audit findings have been resolved.

21-Are we indeed creating a situation where service men and women could be disadvantaged by not having a choice of dealers?

The Big Three auto manufacturers, i.e., GM, Ford and Chrysler, have contracts with AAFES. AAFES has a separate agreement with Overseas Military Sales Group (OMSG) for the sale of U. S. manufactured Hondas.

Each of the Big three operates through an agent. OMSG is now the sales agent for all three manufacturers. OMSG represented GM and Chrysler for years: they began to represent Ford in June of this year. It must be noted that prime contractors can use agents to represent them but the prime contractor is responsible for contract compliance.

AAFES sets the terms and conditions of the contracts. We also enforce them. AAFES representatives continually monitor the operation to assure that prices are correct and customer service is maintained at a high level.

LEVERAGING OF NON APPROPRIATED FUNDS #22

We have received the report on credit for the exchanges. It shows that exchanges went from a net investing position of \$320 million to a net borrowing position of \$840 million. Are you comfortable being in this position? Does it make sense for the exchanges to finance their credit programs in-house and are you doing it at the expense of other efforts?

We believe the referenced report on credit in the exchanges provides a strong independent confirmation that the actions we took to finance DPP were prudent and did not jeopardize the financial well being of AAFES or our ability to generate dividends for the Morale Welfare Recreation activities. According to Price Waterhouse, AAFES continues to have a lower degree of risk and leverage than other major commercial retailers. As a further indication of AAFES' strong financial position, Standard and Poor continues to issue the highest possible short term rating (A-1+) for AAFES. In addition, we are able to access the credit markets at very competitive rates.

The DPP program is efficient and contributes significantly to the AAFES bottom line. We certainly could not expect to generate an equivalent level of earnings or dividends through outsourcing the financing and administration of DPP. It is our view that using internal funds to finance DPP is an effective use of funds and that the return generated from DPP more than compensates for the loss of investment income as well as other opportunity costs. Price Waterhouse confirmed that AAFES has not sacrificed investment in its ongoing business to finance DPP.

In an era of downsizing, DPP is an example of an initiative taken to maintain a reasonable level of earnings and dividends. Outsourcing the financing and administration of DPP would result in transferring dollars outside of MWR channels. The service member's dollars would be going to support a bank's operations and shareholders instead of the MWR activities.

Drawdown

Question: With regard to the drawdown in Europe:

- What is the impact on exchange and MWR operations?
- Is there a need for increased appropriated fund support to supplement a declining financial base which may no longer be self-sustaining?
- Is the weak dollar overseas having an impact on the effectiveness and profitability of MWR programs?

Mr. Pang: The drawdown of our forces in Europe has significantly affected both the exchange and MWR operations. In some instances, many of our MWR facilities maintenance programs have been suspended or dramatically curtailed for lack of funding. Support for small installations geographically separated from larger installations is becoming even more difficult since they are located farther away from support bases and basic quality of life services. The drawdown in Europe has impacted significantly the Army and Air Force Exchange Service contributions to Army and Air Force MWR programs.

As you know, \$194.7 million was added to the Defense program to achieve a baseline per capita expenditure of MWR support as part of Secretary Perry's Quality of Life initiatives. The need for further increase in APF support for MWR programs as part of the quality of life initiative is under review.

The dollar's current value as compared to the major currencies in Europe has remained fairly stable over the past year. However, fluctuations in the exchange rate can increase the labor costs for both the exchanges and MWR programs. This can be seen in the severance and separation costs paid to local national employees as we close down installations.

Residual Value

Question: Please describe the experience in receiving residual value funding for the disposition of facilities overseas?

Mr. Pang: Host nation payment of residual value compensation in the European Theater is, in many instances, based on the reuse utility for the host nation of the facilities vacated by U. S. forces. The Department has not received any residual value funds for NAF facilities on closed overseas installations. Negotiations are continuing, however, and current indications are that payment in kind (PIK) compensation may produce some results.

BRAC Funding

Question: How have you fared in gaining BRAC funding for expansion of exchanges at bases that are expanding due to realignment and base closure?

Mr. Pang: Department policy is that nonappropriated fund activities may compete for available BRAC funding and the Services have successfully competed for BRAC dollars.

- The exchange services have received \$20 million (6 projects)
- DeCA has received over \$18 million (6 projects)
- MWR programs have received \$38.6 million (9 projects)

The exchange services and DeCA have used this funding for store construction and expansion of their existing facilities while in the MWR area BRAC funding has been used for Child Development and Fitness Center construction on installations affected by BRAC decisions.

Consolidated Operations

Question: There are already a number of bases where there are combined PX and commissary operations. There are the NEXMART, the CX Mart, the BX Mart, the Costanza model and the shoppette plus. Would you please describe these operations and how are they doing?

Mr. Pang: These are, to some extent, quite different operations. Their success, from my point of view, is entirely dependent on their overall value to service members and their families. I will defer to General Beale and the exchange commanders for more detailed comment on these operations.

Combining Commissaries and Exchanges

Question: The Panel has learned that nearly \$380 million could be saved each of the first 3 years from the FY 1996 baseline by consolidating exchanges and commissaries. This apparently is based on extending the Carswell model worldwide. Is this accurate? Does such a study exist, and how can the Panel get a copy of this study?

Mr. Pang: I cannot comment on the accuracy of the figures cited because I have not seen the study referred to in the question. In reviewing this matter with my staff, I found that the AAFES staff had looked at extending the Carswell model worldwide. To my knowledge, this excursion was never approved or published. The Secretary of Defense has made clear his view that the commissary benefit must not be eroded. The use of the Carswell model on active duty installations would not meet this test.

Investment Security

Question: What procedures are in place to ensure that the funds invested by your entities are safe and secure?

Mr. Pang: The Department's policy for NAF investments is fundamentally sound. It is based on the principles of safety, liquidity, and yield. Nonappropriated funds are accumulated only to finance identified liabilities, contingencies, and planned capital expenditures. Accumulated funds are safely invested so that funds are available when needed and interest is earned to preserve the value of the funds. The Department is issuing policy clarification to emphasize program management oversight, to include:

- Fiduciary responsibility for nonappropriated fund investments is assigned to the managing Component or Military Service headquarters.
- The Component oversight shall provide for regular reviews and technical advisors who are independent of the control and management of the portfolio.
- Significant losses and circumstances where investments are not earning interest shall immediately be reported to the Component or Military Service headquarters.

Regarding the Department's oversight responsibilities, we are drafting a charter for the DoD Investment Oversight Committee and seeking expert advisors to assist in the annual review.

State Taxation

Question: The Puerto Rico legislature has imposed a tax on alcoholic beverages sold on military bases there. What is DoD doing to fight this initiative, and are there other proposals being made by the States to tax the military resale entities?

Mr. Pang: The Commonwealth of Puerto Rico initially attempted in 1994 to restrict the volume of non-taxed alcohol entering the Commonwealth by imposing a tax on individuals who brought tax free liquor into the Commonwealth. This provision was adopted to impose the tax on anyone

who bought non-Commonwealth tax paid alcohol in any facility. When faced with legal objections from the U. S. military, the provision was limited to curtailing the sale of tax free alcohol at stores operated by the Puerto Rico National Guard.

The U. S. military monitors the actions of the Commonwealth Legislature and takes affirmative steps to ensure that the tax exempt status of federal agencies and instrumentalities is not threatened. Military representatives have met with Commonwealth tax officials to present the military position and have coordinated with the U. S. Attorney's Office in Puerto Rico.

Construction Validation

Question: Please describe your methods of validating the scope of construction projects. What needs to be done to improve the procedures? How does your program benefit from validation studies that are available from commercial consultants?

Mr. Pang: The Department carries out a three part oversight process that covers:

- The initial evaluation of projects using standard submission data.
- On-site reviews of a sampling of projects at various stages of construction.
- An annual status report on approved major and minor construction projects.

For a more detailed description of this process at the exchange services headquarters and DeCA, I defer to the exchange commanders and General Beale.

Financial Performance

Question: Please describe the trends in sales and earnings and where do you see the systems going in their financial performance?

Mr. Pang: The exchange commanders and General Beale can provide you with the details for their activities.

Currency Fluctuations Overseas

Question: Please describe the impact of the adverse currency fluctuations overseas and how are you reacting? Particularly in Japan -- are you benefiting from the Japanese program to pay for foreign national employees?

Mr. Pang: I believe General Beale can provide you with useful insight in this area.

Technology

Question: Please describe your plans for investing in technology and how will this technology enable cooperation among the resale entities and economies in your operations?

Mr. Pang: I have indicated we are actively pursuing a variety of significant issues including cooperative initiatives in the resale community and innovative concepts for the delivery of programs and services. The exchange commanders and General Beale can describe how technology has assisted them in this effort.

Advertising and Competition

Question: What is the DoD policy with regard to advertising and competition with off-base programs?

Mr. Pang: The Department recently revised the policy on Nonappropriated Fund Instrumentality Advertising. This policy change was a result of an initiative by the Department of the Army under the Defense Performance Review. The policy improves business practices for the Services and increases revenues. The new policy allows MWR to advertise in appropriate civilian media when MWR events are open to the public. Such events shall not directly compete with events offered in the local community and should be infrequent. We do not permit advertising merchandise or sale of tax free tobacco products and beverages during these events except for on premises consumption. In addition the policy permits MWR programs (except exchanges) to sell commercial advertising in any media prepared by MWR. Controls are in place for the local installation commanders to make the final decision on acceptance of advertising, and commanders must consider the public perceptions, impact on the local economy, and the effect on local civilian enterprise newspapers. Advertising in installation media is based on reaching bona fide users in accordance with established patronage policies.

In the Commissary, advertising of sales and savings to commissary patrons is restricted to posters, handouts, and other informational media within the commissary and other on-installation locations. Sale prices are never advertised, displayed, or provided in any handout material that may be removed from the commissary. The intent of this policy is to inform the patron how best to maximize commissary savings and not to advertise in competition with civilian grocery stores.

Consolidation

Question: If the joining of the Army and Air Force Exchange Service (AAFES) or other military exchanges with the commissary systems: (1) protects the benefit, (2) has no impact on patrons, and (3) will save millions in tax dollars, then:

- Under what circumstances could this concept be applied system-wide?
- Is the organizational structure that delivers the benefit critical or of major concern?

Mr. Pang: The Department of Defense is not opposed to initiatives that would increase the efficiency of either the commissary or exchange system and save taxpayer dollars, as long as they do not result in the decrement of the current commissary benefit for authorized patrons or a reduction in the morale, welfare and recreation (MWR) dividends generated by the exchanges. The current exchange/commissary structure that delivers these benefits is not critical to the success of these businesses, however, any future exchange/commissary structures will require experienced personnel in retail and grocery management at both the store and headquarters levels.

Duplication of Service

Question: It is my understanding that there are military installations where MWR and exchange activities provide the same services such as barbers, food services and gasoline stations.

- Is this the most cost effective manner in which to operate?

Mr. Pang: Although current regulations provide guidance in this area, we are aware that in some cases there is duplication of services on our installations. We are in the process of reviewing this issue and will, if necessary, clarify our regulations accordingly.

Cooperation

Question: In light of declining exchange sales, earnings and contributions to the MWR fund:

- Are there advantages to be gained from restructuring the military resale system to achieve economies of scale in procurement and reduction of overhead expenses?

Mr. Pang: The Department continues to advocate and support cooperation among the exchange services and the Services MWRs' to increase economies of scale, encourage competition, and increase savings of NAF resources. Significant progress has been made toward cooperative efforts among the resale and services MWR programs.

There are ongoing cooperative efforts in the areas of purchasing and inventory management, distribution and transportation, management information systems, food concepts, facilities design and construction, human resources, satellite TV training, and employee benefits and retirement plans. AAFES, NEXCOM and Marine Corps Exchanges are currently cooperating in the areas of sharing of house brand products; building design and construction support; in-house food concepts; warehousing and distribution; and automated data processing.

Joint Construction

Question: Last year the Defense Authorization Bill permitted nonappropriated fund activities and commissaries to construct shopping malls or facilities jointly, thereby reducing costs and improving construction efficiencies. This represents an important cooperative effort.

- What is the status of this construction change and have any efforts been made to implement the committee's recommendation or law?
- Are there any impediments which are holding back this type of effort?

Mr. Pang: This provision has been incorporated into a coordinated draft Department of Defense Instruction 1015.1, "Establishment, Management, and Control of Nonappropriated Fund Instrumentalities (NAFIs) and Related Activities." There are no known impediments which are holding back this effort.

DeCA and the Navy Exchange Service Command are currently working a joint construction project at Port Hueneme, California. DeCA is leading the effort to procure both a commissary and a Navy Exchange under a single design/build contract.

Carswell Report

Question: The Department's February 24 report on the Carswell AFB Exchange Mart indicates that the effort was a "marginal success." Yet, edible food was sold at a 26% savings to the patrons and no taxpayer dollars were used. If operated as a commissary, about \$4.5 million in appropriated funding would be needed to achieve the same result.

- How do you define "marginal?"
- Why was no mention made in the DoD report that millions in tax dollars were required to achieve a similar benefit?
- As long as the commissary benefit is maintained, is the organization that delivers it critical or of major concern?

Mr. Pang: As shown in the February 24 report, the exchange mart, as a free standing activity, lost \$1,259,112. It was only when all the profits from the other exchange activities (Main Store, Class Six and Shoppette) were used to offset the losses of the exchange mart, that overall exchange operations at Carswell AFB made a \$383,224 profit. This was less than one half of one percent of total sales. Using normal exchange standards to determine loss and marginal activities, the exchange mart was a loss activity and the exchange as a whole was only marginal. Although it is true that the exchange did reduce expenses, as a percent of sales, below the prior year commissary level, it did not translate sufficiently to the bottom line to offset the loss of \$1,259,112. The Department is not opposed to the use of the exchange mart model as tested at Carswell AFB, as long as it is used at closed and realigned installations that are near enough to a large metropolitan area that there will be a population base sufficient to make the operation economically viable. As mentioned before, the Department does not support using the exchange mart model on active duty installations, due to the loss in the commissary benefit from selling normal commissary non-food items at the regular exchange mark-up. The Department fully supports seeking alternative methods to providing the full commissary benefit, if there is no loss in the MWR dividend. To continue delivering the commissary benefit under a revised organizational structure requires experienced management personnel above the store level in the grocery and retail operations and merchandising environment.

Commissary Sales Declines

Question: Commissary sales peaked at slightly more than \$6 billion in fiscal year 1991 and dropped to \$5.5 billion in 1994. They are projected to decline to \$4.5 billion by 1999.

- What management actions are being taken to realize economies-of-scale to ensure that a higher overhead percentage doesn't have to be passed on to the patron?

Mr. Pang: DeCA has taken a number of initiatives that increase cost-efficiency. General Beale can provide some examples.

Issuance of Commercial Paper by Exchanges

Question: In order to finance the credit programs of the exchanges, your March 17 report to the Congress says that you will recommend the issuance of commercial paper by the exchange. Why was this option favored versus out placement of this risk to a commercial bank?

Mr. Pang: At this time the exchange services do not anticipate issuing commercial paper. However, the Price Waterhouse report on the exchange credit programs listed the following advantages to the exchanges issuing commercial paper (CP):

- CP is an inexpensive source of working capital financing.
- There is market demand for highly rated commercial paper
- Considered a prudent short-term investment vehicle
- Disintermediation of the banks results in lower costs
- CP is a flexible source of financing
- Maturity of CP can be tailored to the needs of the issuer
- Levels of CP issues can be changed through short-term maturities
- CP is a negotiable financial instrument

- A secondary market for CP exists, resulting in increased liquidity.

Price-Waterhouse estimates that projected savings using CP to help finance purchases over commercial banking institutions are between \$750,000 to \$950,000 for AAFES per year and \$131,000 for NEXCOM.

Credit

Question: We have commercial credit cards, the Marines, Navy and Army and Air Force have exchange credit cards, the Air Force has an MWR credit card, and the Army has an "Esprit" Credit Card. Also the commissary agency is testing accepting credit cards.

- What is being done to ensure service members don't get overextended in their use of these credit cards?

Mr. Pang: In a March 17, 1995 memorandum to the services, the Department required the credit programs referenced above to obtain credit checks on all new accounts and to report both good and bad credit to commercial credit bureaus, consistent with the Debt Collection Act and the Privacy Act. The Department's credit programs do offer more favorable interest rates than is available to service members from most banking institutions. The exchange credit programs also offer service members an alternative to buying on credit on the commercial market, resulting in savings both from the lower interest and the normal savings on exchange merchandise. Further, the exchanges will work closely with service members who do have financial problems to reduce the service members' monthly payments to manageable levels.

Executive Resale Board

Question: Do you believe that there needs to be more active oversight by DoD of the various entities of the military resale and MWR program and how could you empower the DoD executive resale board to effect binding arbitration over these entities to include allocation of resources and cooperation?

Mr. Pang: The DoD Executive Resale Board is administered consistent with the provisions of DoD Directive 5105.18, "DoD Committee Management Program." The board is a forum for leaders of the exchanges, commissary and Service MWR programs to discuss resale and MWR business operations and provide recommendations and issues to me. Consistent with the provisions of the Department, all policy issues identified by the membership are staffed to the Services and within the Department.

Binding arbitration over the entities including allocation of resources is outside the parameters of the board.

Health Benefits

Question: The Congress directed a single and uniform health benefit program for nonappropriated fund employees. How is this effort going?

Mr. Pang: The FY 95 Authorization Act required the Secretary, not later than October 1, 1995, to "take such steps as may be necessary to provide a uniform health benefit program" for NAF employees. Last fall, the Department allocated funds and began the lengthy procurement process to obtain an employee benefits consulting firm to analyze the current six NAF employee health care plans and recommend a uniform program as a replacement. We are currently evaluating proposals from firms with expertise in health benefits. Award of contract will be made as soon as all required procurement procedures are completed. The contractor selected is expected to require several months to analyze and prepare recommendations.

As you know, in February of this year, we advised you that we had allocated funds and taken action to contract for study by an employee benefits consulting firm. Hay/Huggins, the actuarial and benefits consulting arm of the Hay Group, a world-wide human resources consulting firm,

was selected. The company brings over 80 years of benefits and actuarial consulting experience to the NAF health benefits project.

Hay/Huggins will analyze the existing NAF health plans and develop options for a uniform replacement plan. We expect the reports by February, 1996. The Department will select the option that offers the best balance of coverage and cost. We will then report to you on the new program and our implementation plans.

Savings to Patrons

Question: What are your most recent findings of savings to patrons? Would one savings survey for all of the DoD resale entities be useful so that everyone is comparing apples to apples?

Mr. Pang: The most recent market basket survey conducted by NEXCOM was in 1993 and that survey showed an average savings of 18.4%; AAFES most recent market survey was 1995 and showed a savings of 19.7%; and the Marine Corps survey completed in 1992 showed a savings of 19%. DeCA's most recent price comparison was done in 1993 and showed a saving of 23.4% to our patrons.

Exchange Cooperation

Question: The Logistics Management Institute conducted a study of consolidation of the consolidating some or all functions of these systems. Given the decline in earnings, a reduced patron base and multiple base closures, isn't it time that DoD revisited this issue?

Mr. Pang: The Department does not advocate consolidation of the exchange services. The downsizing of the active component is now over eighty percent complete and the reductions we plan for fiscal year 1996 will essentially complete the drawdown of our active forces. During this process, the exchange services have been aggressively improving their individual productivity to maintain profit levels and market share. These competitive initiatives are powerful incentives that, unlike downsizing, are still ongoing.

The Department made the decision not to consolidate the exchange services, but instead directed that the exchange services engage in cooperative efforts to reduce overhead expense, encourage competition, increase savings in NAF resources, and increase efficiencies. Currently, the exchange services have initiated a number of cooperative efforts, and each of the exchange services are in the process of developing specific proposals that may be exported to the other exchange services.

While the Department does not believe that consolidation of the exchange services would be in the best interest of service members and their families, we support cooperative efforts that make good business sense and are monitoring these developments.

Carswell AFB Test

Question: The Panel has learned of a study conducted in DoD regarding the potential for savings if commissaries and PXs were consolidated. This study shows that within four year, savings of \$477 million per year would be realized from the FY 1996 baseline. Have you seen this study and could you share your thoughts on it?

Mr. Pang: No, I have not seen the study. Should I receive a study on this issue I will be pleased to share my thoughts following such evaluation as might be appropriate.

Advertising and Competition

Question: What is the DoD policy with regard to advertising and competition with off-base programs?

Mr. Pang: Please see question #15 for my earlier answer.

Cigarette Sales

Question: Is it true that Navy ships' captains are authorized to sell tax free cigarettes at tax paid prices while under deployment. If so, why?

- Doesn't this erode the benefit for sailors at sea that are supported with appropriated funds?

Mr. Pang: Tax free cigarettes on deployed Navy ships are sold at tax free prices, not at tax paid prices. Ship captains are not authorized to alter this practice. Therefore, there is no erosion of the benefit to sailors at sea.

Answer: One important area is the need to amend the law underlying the decision of the Comptroller General at 58 Comp. Gen. 94 (1978). We are therefore preparing legislation, which will be coordinated pursuant to the customary procedures established by the Office of Management and Budget, that would authorize non-appropriated fund operations, such as the exchange services, to enter into contracts with appropriated fund entities such as the Defense Commissary Agency (DeCA), to provide goods and services to the latter. Currently, contracting between those entities is prohibited and that prohibition has hindered cooperative initiatives among our exchanges, DeCA, the Morale, Welfare and Recreation (MWR) programs.

With legislation that changes the law underlying 58 Comp. Gen. 94 the exchanges, DeCA and MWR programs could legally contract for the procurement of goods and services as if the exchanges and other MWR programs were non-governmental entities. Those contracts would, of course, continue to be governed by applicable law and regulation. We believe such contracts could result in lower prices to service members and the sharing of common services for the benefit of the entire military community.

Residual Value

Question: Please describe the experience in receiving residual value funding for the disposition of facilities overseas.

General Beale: The Defense Commissary Agency has not received any residual value funding for commissary facilities closed in overseas areas.

BRAC Funding

Question: How have you fared in gaining BRAC funding for expansion of exchanges at bases that are expanding due to realignment and base closure?

General Beale: The Defense Commissary Agency has received \$18.2 million in BRAC funds to support construction of six commissaries. Ten million dollars was received in 1991 for March Air Force Base; \$3.7 M in FY 1992 for Luke AFB and Fort Myer, VA; \$3.6 M in FY 1993 for Everett, WA; and \$.9M in FY 1994 for Great Lakes NTC and Cannon AFB.

Consolidated Operations

Question: There are already a number of bases where there are combined PX and commissary operations. There is the NEXMART, the CX Mart, the BX Mart, the Costanzo model and the shoppette plus. Would you please describe these operations and how are they doing?

General Beale: Combined commissary/exchange operating concepts such as the NEXMART, CX Mart, BX Mart, the Costanzo model, and the shoppette plus, are cooperative efforts between DeCA and the exchange systems to provide commissary and exchange items to military members at the most efficient operating cost. A brief description of each follows:

NEXMART and CX Mart: These are similar combined operations in certain overseas locations, generally remote, which are operated by the exchange system. They stock a full range of commissary categories, with one or two exceptions. DeCA provides commissary merchandise at cost and it is sold to the customer at cost plus the 5 percent surcharge at the register. DeCA reimburses the exchange with appropriated and surcharge funds for the labor and operating costs of these operations, based on a sales proration formula. The 13 NEXMARTs were established by the Navy prior to DeCA's inception. The CX Mart operation was created in response to the FY 1993 DoD Authorization Act to test the concept where an OCONUS commissary had closed. These types of operations have not proven to be successful from an operating cost perspective. DeCA has no plans to expand this concept.

BX Mart: This is a combined exchange and commissary operated by AAFES. The BX Mart was created as a demonstration program under the FY 1993 DoD Authorization Act, to test the concept on an installation closed as a result of BRAC. There are currently two, located at Carswell, TX and Homestead, FL. Under the demonstration program the BX Mart sells edible food items at cost plus 5 percent, the markup being reflected in the shelf price. Cigarettes are sold at cost plus 16 percent; all other products are sold at the AAFES retail markup. The BX Mart adds exchange commodities, such as beer, wine, and greeting cards which are not authorized for sale in commissaries. DeCA provides no support to BX Marts and AAFES receives no appropriated fund support for BX Marts.

Costanzo model and shoppette plus: These concepts are being tested as a limited combined effort in Europe to provide a reduced form of a commissary and exchange benefit in certain locations, where it is no longer efficient to operate a separate commissary or exchange due to force structure drawdowns. Results expected after testing of these models are reduced costs of operation for DeCA and the exchanges with the closure of inefficient operations.

The Costanzo model is a commissary annex operated and staffed by DeCA that also sells selected exchange categories on consignment. The separate exchange facility is closed. The commissary portion is supported with appropriated funds. The exchange reimburses DeCA based on a percentage of exchange sales. Commissary items are provided to customers at cost plus the 5 percent surcharge, and exchange items at the ordinary exchange retail markup. This model is located in housing areas located at Costanzo, Sicily and Aschaffenburg, Germany. Both are within 30 minutes of a larger nearby commissary and exchange.

The shoppette plus model is an AAFES shoppette operated and staffed by AAFES personnel, which sells 100 basic commissary food items at cost plus a 5 percent AAFES mark up. AAFES purchases these items from DeCA at commissary cost. DeCA funds the transportation costs since the products are dropped off from trucks already on a normal commissary transportation route. The separate commissary operation is closed. The community demographics are single or unaccompanied military and limited families. This model is located at Giebelstadt, Germany and is within 30 minutes of a nearby larger commissary and exchange. While the operation is successful, customers are concerned by the limited number of items sold at the normal commissary price.

State Taxation

Question: The Puerto Rico legislature has imposed a tax on alcoholic beverages sold on military bases there. What is DOD doing to fight this initiative, and are there other proposals being made by the States to tax the military resale entities?

General Beale: It has been suggested from time-to-time that state sales taxes should be imposed on purchases from Exchanges and Commissaries. Such a practice would have far reaching effects on the savings generated for commissary patrons, as well as the operating expenses of DeCA.

State sales taxes are collected in 45 jurisdictions (44 states and the District of Columbia) where DeCA has commissaries. However, because the incidence of sales tax is limited in many states on food and nonprescription drugs, only 18 of the states collect sales taxes on all items in commissaries. Partial tax would be collected in the remaining 27 states because they exempt food and/or nonprescription drugs items from tax (or in the case of Illinois charge a different rate on food and nonprescription drugs). Exemption of tax on these items does not eliminate all taxes on items sold in commissaries since taxes on other items such as laundry products, health and beauty aids, paper products, etc. (the definition of what constitute food and nonprescription drugs varies from state to state), would still be collected. According to the Federation of Tax Administrators, as of July 1994, state sales taxes range from 3 to 7 percent nation-wide. In addition, some counties and cities also charge a sales tax that is not reflected in the above range and is generally not available to DeCA. For example, the sales tax rate for Virginia is shown to be 3.5 percent (which goes to the state) but it fails to mention that one percent is collected under the state law for the benefit of counties and cities.

The last market basket survey was conducted by the Wirthlin Group in June 1993. That survey indicated an average savings of 23.4 percent. The savings determined included adjustments for taxes in the locations surveyed and the commissary surcharge. We have no way of determining the effect of sales tax on savings in a particular state, or in states that exempt food or nonprescription drugs. However, if sales tax was imposed at the full rate, it would decrease the patron savings by an amount equal to the tax rate. Average savings by Region as affected by sales taxes would be:

Current Range of Sales Projected

Region	Savings	Taxes in Region	Savings w/Sales Tax
Northeast	23.8%	3.5 - 7%	16.8 -20.3%
Central	20.8%	3.5 - 6.25%	14.55 - 17.3%
Southern	20.8%	4 - 7%	13.8 -16.8%
Midwest	23.6%	3 - 6.25%	17.35 - 20.6%
Southwest	27.2%	4.875 -6.5%	20.7 - 22.325%
Northwest	24.4%	4 - 6.5%	17.9 -20.4%
Total DeCA	23.4%	3 - 7%	16.4 -20.4%

DeCA overhead would also be affected by the imposition of state sales taxes on items sold in commissaries. DeCA estimates it would require an additional 50 man-years (primarily accounting personnel and lawyers) to comply with state tax laws and regulations.

In addition, the question of excise tax on tobacco products would also be opened since it would be difficult to make an agent of the federal government collect sales taxes, while attempting to prevent the collection of state excise taxes on tobacco. Making commissary patrons subject to the payment of state tobacco taxes would further affect savings.

Deployments

Question: Would each of the resale commanders describe their system's role in mobilization for war or other contingencies? What has been the experience and what needs to be done to improve the procedures for assisting in deployments?

General Beale: In the past, troop issue services provided by the Defense Commissary Agency (DeCA) were predominantly in support of the Air Force. DeCA also provided the military personnel for the operation of AAFES Tactical Field Exchanges during recent deployments to such areas as Somalia. As a result of PBD 418 and PBD 419, effective October 1, 1995, DeCA will no longer have a direct support role in mobilization for war or other contingencies. The Troop Subsistence and Field Exchange missions were returned to the U.S. Air Force, as well as the military personnel positions associated with these functions. DeCA's main support role is focused on providing the commissary benefit to the families left behind, which is most important both to the families and to the peace of mind of the deployed family members.

Construction Validation

Question: Please describe your methods of validating the scope of construction projects. What needs to be done to improve the procedures? How does your program benefit from validation studies that are available from commercial consultants?

General Beale: In the past few months DeCA has reevaluated every aspect of the processes by which stores are sized, programmed, validated, and reviewed. We have made a great deal of improvement in the areas of standardized reports, quality of information, and on site project assessment. Our process now includes four steps before a project is submitted to Congress for approval. Each of these steps serves as part of the validation process. The steps are described below;

- Identification of requirements
- Engineering Analysis
- Economic Analysis
- Coordination Outside DeCA

- Identification of Requirements. By and large, the DeCA construction program is internally generated with most requirements being defined by HQ DeCA but also flowing from the stores, to the DeCA regions, and then to HQ DeCA. There are exceptions to this, for example when the initial impetus for a project comes from the Service or the Installation. DeCA planners determine projected sales, sizes, project scopes, costs, alternatives, etc., and have therefore validated each and every project in the earliest planning stage possible. DeCA planners review and validate the continuing need for commissary projects as changes occur that affect commissary project requirements.

- Engineering Evaluation. DeCA's engineering evaluations consistently seek to evaluate every aspect and every alternative to new construction. Clarifications to our previous analytical methods, such as discounting tobacco sales, expansion of store hours and consolidation of facilities, have been developed. Detailed information regarding existing assets, physical condition, citing, age, alternatives, costs etc. are now documented in an Engineering Evaluation (EE) report for each and every project. Through the following, the EE documents examination and development of options to correct facility deficiencies.

On Site Inspections	Square Foot Analysis	Cost Estimates
Economic Analysis	Parking Analysis	Utility Availability
Condition Analysis	Patron Loading Analysis	Demographic Surveys
Market Analysis	Maintenance Reports	Photos

- Economic Analysis. DeCA has improved its documentation of consideration of alternatives to new construction. We use a formal economic analysis process to infuse the life cycle cost into our decision making process. Alternatives developed in the engineering evaluation are compared in the economic analysis (EA). DeCA has elected to use the U.S. Army Corps of Engineers, Huntsville Division, Automated Economic Analysis Package (ECONPACK) software to conduct EAs of its commissary projects.

- Coordination Outside DeCA. The last step in the process is coordination of the project outside the Agency. All projects are presented to the Defense Commissary Board, Construction Requirements Review Committee (CRRC) two years prior to proposed execution. The CRRC is made up of representatives from each Service, DeCA, and from the office of the Deputy Assistant Secretary of Defense (DASD) for Personnel Support, Families and Education (PSF&E). The CRRC provides input from the Services and the OSD level. Finally, as part of the PSF&E oversight role DeCA's major construction program is coordinated to ensure compatibility with MWR and exchange projects and overall DoD force structure plans.

DeCA has worked closely with the DoD IG on the question of project validation as reflected in the following quote from a May 24, 1995 letter from Robert J. Lieberman, Assistant Inspector General for Auditing to the DASD (PSF&E).

"Proper implementation of the new procedures should correct the deficiencies noted in the audit report. We will continue to work with the DeCA staff to make additional improvements to the DeCA process for validating construction requirements. Additionally, the procedures proposed by the Director, DeCA, should eliminate the need for an independent validation of project requirements."

DeCA feels strongly that we have a good process for project validation that results in an efficient and effective construction program.

Financial Performance

Question: Please describe the trends in sales and earnings and where do you see the systems going in their financial performance?

General Beale: Rightsizing of the Force and base closures have clearly impacted commissary sales. We estimate that sales will decline 13.8 percent between FY 1992 and FY 1995. Surcharge revenue over the same period is expected to decline by 10.3 percent. With our bill paying problems behind us we are able to take full advantage of payment discounts offered by our suppliers. These discounts are returned to the commissary surcharge account to benefit the commissary patron.

Foreign Currency Fluctuations Overseas

Question: Please describe the impact of the adverse currency fluctuations overseas and how are you reacting? Particularly in Japan -- are you benefiting from the Japanese program to pay for foreign national employees?

General Beale: In FY 1995, DeCA estimates that adverse foreign currency fluctuation will impact its budget by approximately \$9.4 million. Because DeCA is not funded for adverse foreign currency fluctuation, we must absorb these additional costs within our current funding to the extent possible. Any unabsorbed foreign currency losses result in an operating loss.

DeCA is benefiting from the Japanese labor cost sharing program to pay for foreign national employees. Under the current labor cost sharing agreement between the U.S. and Japan, the Government of Japan (GOJ) pays part or all of the costs for Japanese National employees working in commissaries in Japan and Okinawa. The GOJ paid for 75 percent of basic wages. Also, the GOJ pays for Japanese National employee benefits and allowances amounting to approximately 36 percent of total Japanese National payroll. The loss of labor cost sharing from GOJ would seriously impact the level of commissary service to our patrons stationed in Japan and Okinawa.

Technology

Question: Please describe your plans for investing in technology and how will this technology enable cooperation among the resale entities and economies in your operations?

General Beale: Both the Defense Commissary Information System (DCIS) and the Point of Sale (POS) Modernization Programs represent a commitment to moving from inflexible and proprietary legacy systems to commercial off the shelf (COTS), open architecture systems which facilitate data sharing among resale agencies. We are also exploring strategies for the use of the improved information these systems will make available. DeCA is a member of the DoD MWR and Resale Management Information System Forum, a group formed to promote the free flow of information and cooperation within the Military Resale community. These efforts should result in increased joint procurement and lower overall costs.

Advertising and Competition

Question: What is the DOD policy with regard to advertising and competition with off-base programs?

General Beale: In the Commissary, advertising of sales and savings to commissary patrons is restricted to posters, handouts, and other informational media within the commissary and other on-installation locations. Sale prices are never advertised, displayed, or provided in any handout material that may be removed from the commissary. The intent of this policy is to inform the patron how best to maximize commissary savings and not to advertise in competition with civilian grocery stores.

Centralized Buying

Question: The commissary system is moving toward more centralized purchasing procedure;. What is the rationale for moving to this system and how do you see the process working? How does industry view this practice?

General Beale: The rationale for centralizing certain purchasing functions is to take advantage of the efficiencies brought about by the emerging technologies in the food business. Initially, we concentrated on centralizing some of the more redundant and repetitive functions being performed at our regions, such as file maintenance. Performing the same function for identical items in multiple locations was simply not efficient. The development of Resale Ordering Agreements (ROAs) and Electronic Data Interchange (EDI) has significantly reduced costs, while improving service levels to stores, regions, and industry. Similarly, the centralization of item management for national brands within the majority of categories not only provides cost savings, but also offers the capability to effectively implement category management, improve business performance, and integrate the basic strategies of Efficient Consumer Response (ECR) within our daily operation. At this juncture, the reaction from industry to our current efforts has been overwhelmingly positive.

Commissary Construction

Question: The Panel currently has the commissary construction program on hold pending the resolution of some differences between the commissary system and the DOD Inspector General. The DODIG has been highly critical of the plans for a number of your stores saying that they are overscoped or not needed at all. How do you see this impasse being broken?

General Beale: Although some differences between DeCA and the DoD IG remain, the impasse that delayed release of DeCA's FY95 major construction program has been resolved. The following excerpts are quoted from a May 24, 1995 letter from Robert J. Lieberman, Assistant Inspector General for Auditing to the DASD (PSF&E).

"On May 12, 1995, the Director, Defense Commissary Agency (DeCA), provided the Inspector General, DoD, official comments on the audit of commissary construction requirements. My staff reviewed those comments and supporting documentation and concluded that DeCA has made significant procedural improvements in its facility planning process."

"Based on the improvements to the DeCA facility planning process, I recommend that the FY 1995 commissary construction program be allowed to proceed."

Most of the problem areas and concerns raised by the DoD IG in their audit of DeCA's commissary construction planning and programming process have been resolved. DeCA is now rewriting and standardizing its procedures accordingly. Differences with the DoD IG remain on two specific projects, Fort Bragg and NAS Pensacola. It appears that these will require a mediation through DoD channels.

Commissary Construction

Question: The DOD Inspector General is recommending that --instead of building bigger commissaries -- that they be kept open longer hours like commercial supermarkets. In fact, the IG says that DECA spent \$20 million more than needed at the six stores they reviewed. And, since surcharge funding is used for building stores, the IG is recommending that surcharge funding be used to keep the stores open longer. What is your view of this recommendation and when are we going to see some reconciliation between the DECA and IG point of view?

General Beale: The DoD IG was not correct when they stated that DeCA spent \$20 million more than needed at six stores. DeCA demonstrated to the IG that their cost estimating methodology was in error. In view of the legitimate disagreement between the IG and DeCA on this point the wording of the final audit report is;

" DeCA spent Commissary Surcharge Collection Funds for commissary square footage that may have been in excess of patron requirements."

The permissible uses for surcharge funds are specified in federal law. DeCA does not have the authority to extend commissary operating hours and pay the labor costs out of surcharge. Extending operating hours and/or adding days is not a panacea and the implication in this report that it is an all inclusive option is wrong. The single focus argument presented by stating that longer hours produce more sales by flattening peaks is not a stand alone solution. Individual stores may indeed be available to a broader spectrum of patrons by extending their hours and/or adding shopping days.

To some extent the DeCA and IG positions are reconciled in that DeCA always considers extended hours as a possible option. We examine the option of extended hours and/or additional shopping days in conjunction with the local installation staff and commissary council, but only implement it when the operational judgment is made that it can produce the desired results within our work year ceilings.

Use of Surcharge

Question: The five percent commissary surcharge was authorized by Congress to pay for construction and other very specific expenses such as: construction, maintenance of equipment and the purchase of supplies. Are there other uses for this surcharge funding and is it being used in areas beyond the scope that Congress originally envisioned?

General Beale: We believe that the current authorized uses of the commissary surcharge are adequate. We do not generate sufficient surcharge dollars currently to fund as robust a construction program as needed. We carefully follow the intent Congress envisioned in establishing the surcharge and do not believe we have gone beyond that scope.

Commissary Sales Declines

Question: Commissary sales peaked at slightly more than \$6 billion in fiscal year 1991 and dropped to \$5.5 billion in 1994. They are projected to decline to \$4.5 billion by 1999. What management actions are being taken to realize economies-of-scale to ensure that a higher overhead percentage doesn't have to be passed on to the patron?

General Beale: To maintain and improve commissary product prices for our patrons and reduce supplier overhead costs, DeCA has instituted a number of initiatives which offset any decline in our buying leverage due to reduced sales from rightsizing the Military Force and closing bases.

For example, DeCA is centralizing the buying of name brand products and introducing category management into our business process to improve buying strategies and obtain better product deals on prices for the commissary patron. In addition, we are partnering with suppliers to use electronic data interchange and delivery ticket invoicing to reduce our suppliers' overhead costs so that they are not passed on in higher product prices. These initiatives are also reducing DeCA's overhead costs which are subsidized by appropriations.

Cost of Goods Sold

Question: The panel has received information that--for those items that are sold by both AAFES and commissaries--AAFES gets them to the store 10 percent cheaper than commissaries. This appears to argue that AAFES should purchase and distribute these products so that the patron could save this ten percent, especially since AAFES has a distribution system in place and most stores are located next to each other. Why wouldn't you take advantage of this opportunity to lower costs to the patron?

General Beale: The bulk of products purchased by DeCA for resale to customers is comprised of food products in the grocery, meat, and produce categories. Most of these type items are not warehoused by AAFES for distribution to their retail outlets. Commissaries also stock selected non-food categories, such as household items, tobacco, detergents, and health and beauty aids (HABA). Currently, all these categories of product are generally delivered daily or several times per week by manufacturers to commissaries, either by their major distributors through the frequent delivery system (FDS) or direct through the Direct Store Delivery (DSD) distribution method. These distributor transportation costs are included in the price of the product to DeCA. DeCA was prohibited from operating central distribution centers (CDCs) in the United States. The use of FDS and DSD has enabled DeCA to significantly reduce inventories, increase in-stock positions, offer fresher product to the customer, and eliminate appropriated fund labor costs previously used to operate CDCs. The savings realized more than offset the incremental cost to the patron.

We are aware, of course, that AAFES, because of its CDC operations, can forward buy large quantities of some products at potentially better prices than DeCA, due to volume buying. This purchasing method is, however, losing its appeal in the supermarket industry due to the disproportionate costs and handling fees connected with maintaining large blocks of assets for future sale and we have been told that the industry in the United States is migrating to the DeCA FDS system.

The majority of common stockage between AAFES and DeCA falls in non-food categories warehoused in their CDCs, such as health and beauty aids (HABA). The assumption that DeCA could sell these items at the AAFES price if procured and shipped by AAFES is questionable, as AAFES would pass on distribution, transportation, and related overhead costs to DeCA in prices of products. Additionally, industry concern would again be generated if the government (in this case AAFES) performed the warehousing and distribution function (as DeCA did in the past), instead of using commercially available distributors performing the same service.

DBOF

Question: In your personal view, does it still make sense to have the commissaries operating under the Defense Business Operations Fund (DBOF) or should we remove the system from this structure?

General Beale: Yes, it still makes sense to keep DeCA in the DBOF. A major benefit of keeping commissaries in DBOF is that they operate under financial procedures that provide improved total cost visibility and accountability to enhance the decision making process. The flexibility of DBOF allows DeCA to operate in a more efficient, cost effective, business-like manner. By identifying total cost and giving commissary systems managers the authority and flexibility to make cost trade-off decisions, more can be done to control costs and promote operational efficiencies.

Question: Also, last time you appeared before the panel, you said that you were resolving the levels of charges by base commanders to DeCA for services such as security and trash collection. Have you resolved this matter?

General Beale: Yes. Revised guidance in Department of Defense Instruction for Interservice and Intragovernmental Support was issued August 9, 1995. This guidance requires that host organizations be reimbursed for only identifiable and measurable incremental costs for base support requirements provided to commissaries. We are currently renegotiating with host installations for base support using the incremental cost policy.

Distribution

Question: You have closed your central distribution facilities in the United States and moved to frequent delivery of products by commercial distributors. Has this caused any increase in prices to the patron?

General Beale: The closure of CDCs and reliance on FDS has resulted in increased prices to the patron. This effect was understood when the decision was made. It was a trade off for improving the overall efficiency of our system. Industry operates much more cost effective distribution systems than DeCA did. The incremental cost passed to the patron is much less than the savings generated from the reduction in storage space, material handling equipment and labor as a result of using FDS. Additionally, DeCA has been able to take advantage of other price reduction initiatives which have offset these increases, keeping prices relatively constant for the customer.

Cause Promotions

Question: The purpose of the commissary is to offer name-brand recognizable products to the patrons at cost plus the five percent surcharge. Recently, we have seen a movement toward using the commissary to raise money for private causes such as the Red Cross, USO, and MWR? What is driving this trend? Why is a taxpayer subsidized organization being used for fund raising?

General Beale: Cause promotions within the grocery industry and the commissary system are not a new phenomena. Special Olympics, Jerry's Kids, and a host of other organizations have been supported by food industry manufacturers over the years, with the food retailer acting as the focal point. These promotions, which blend solid price discounts with support of worthwhile causes, are merely another method which manufacturers use to promote their product lines at store level. In planning its promotional programs, DeCA evaluates only the terms of a given offer, and assesses its potential to generate savings for DeCA customers. The fact that a promotion may involve donations to a cause is irrelevant to this decision. The manufacturer makes the donation (not the commissary), based on the sales results at the end of the promotion period.

Credit Cards

Question: Are commissaries accepting credit cards? If so, why wasn't the Panel notified of this?

General Beale: DeCA received an invitation from the United States Treasury to participate in its already established plastic card program. The acceptance of credit cards by the grocery industry in the United States was found to be a prevailing business practice. Under the Treasury program, Federal agencies throughout the government accept credit cards as payment for goods and/or services. The purpose of the program is to reduce the cost of the national debt by getting funds into the Treasury faster than the normal time for clearing checks. Under the Treasury Department program, all costs for processing credit card transactions are absorbed by the Treasury. DeCA agreed to test patron acceptance of the program to determine if there was a demand for this form of payment. Working closely with the Treasury Department, the DoD Comptroller, and a bank designated by the Treasury, DeCA established a test program at 16 commissaries to accept Mastercard and VISA from patrons. In addition, thirty-two commissaries are accepting Mastercard and VISA credit cards for payment for commissary purchases by

Nonappropriated Fund Instrumentalities (NAFIs) and for payment from vendors for vendor credit memorandums (i.e., promotion price reductions). Through this initiative, DeCA has been able to directly reduce operating costs for all parties concerned.

Non-food Items in Commissaries

Question: We understand that the addition of non-food items such as batteries, hosiery, pet food, cleaning supplies and health and beauty aids into commissaries is a relatively recent development. Has this detracted from the ability of the exchanges to make money and does it deviate from the commissaries intended purpose?

General Beale: The stockage lists in industry have steadily expanded over the years, as have the list of products authorized in a commissary. Pet food and household products have been sold in commissaries for at least 30 years, and health and beauty aids for almost 25 years. The decision to stock batteries and hosiery was approved by the Panel in the late 1980's. The introduction of these commodities into commissaries did not affect exchange sales, but had the net effect of expanding total category sales throughout the military market. DeCA has been and will continue to be very sensitive to the complementary nature of the exchange/commissary relationship, but also feels a commitment to provide the maximum savings to the military patrons as part of their compensation package. The inclusion of these commodities in commissaries is consistent with their intended purpose.

Tobacco

Question: The sailors take a double hit on tobacco. Not only are they prevented from purchasing it at commissary prices, the mark-up on tobacco is ten percent higher in Navy-and Marine Corps PXs than Army and Air Force PXs.

What is the specific justification for this inequity?

General Beale: The policy of not selling tobacco in commissaries on Navy and Marine installations resulted from an agreement between a former Assistant Secretary of Defense for Production and Logistics and the Secretary of the Navy as a concession to receiving the Navy's support for consolidating the commissary system. The Navy feels strongly that any change in this policy would negatively impact on its smoking cessation policy.

Question: The sailors take a double hit on tobacco. Not only are they prevented from purchasing it at commissary prices, the mark-up on tobacco is ten percent higher in Navy-and Marine Corps PXs than Army and Air Force PXs.

Shouldn't all military personnel pay the same price for cigarettes?

General Beale: I agree that all commissaries should sell cigarettes at cost plus five percent.

Category Management

ISSUE: A draft RFP issued October 1994 by DeCA calls for the implementation of Category Management, a new product movement information system. This concept, widely used in the commercial retail industry, enables retailers to improve the variety of products available and lower the cost to customers. Most important, it enables retailers to improve their competitive performance, thereby increasing revenues. For DeCA to implement Category Management, as done in the commercial sector, it entails access to local competitor information, DeCA sales data, and promotional and consumer behavior related information.

Question: What are the goals of the new system contemplated under the draft RFP? To what extent will the system enable DeCA to analyze local competitive sales trends, evaluation promotional information and obtain access to training on industry standard category management?

General Beale: Our overall goal is to secure category management support services that will enable DeCA to fully implement category management, which will ensure we are meeting the product needs of our patronage. An integral part of category management is the ability to assess DeCA's strength in the marketplace on a category by category basis. The service we are attempting to secure will provide a number of things: the commercial and commissary data necessary to analyze product mix effectiveness, a system to perform the analysis, and the support and service required to efficiently develop category plans and strategies to improve performance. The analytical techniques of the process encompass product assortment determination, promotional evaluation, pricing strategy development, and in-store execution of category plans. The RFP requires the contractor to provide the necessary training in the use of the system to carry out the category management process.

Store Hours

ISSUE: The operating hours for the Commissaries are shorter than competitive private sector grocery retailers. There is some indication from a study entitled "The Patron Satisfaction Survey," conducted by the Wirthlin Group in 1991, that this may be an important reason why military patrons shop in private grocery stores.

Question: Are there any plans to extend the hours of operation of the Commissaries?

General Beale: It is true that private sector grocery retailers operate for longer hours than commissaries. They are profit generating entities and can staff their stores to operate any number of hours as they determine necessary based on sales. The private sector retailer establishes hours, selects stock assortment, and tailors its whole operation to maximize profits.

The labor costs to operate commissaries are paid from appropriated funds; thus operating hours are limited by the appropriated funds available. A commissary must set hours based upon the appropriated funds it is given to operate. DeCA supports its commissaries with the optimum mix of hours, within the funding limitations, for the demographic population of a base, based on periodic local patron surveys of our customers. We work very closely with each installation and its Commissary Advisory Council to make the maximum patron service available during the times which directly support the patron. DeCA does not receive the appropriated funding to permit operating its stores the same hours as our commercial counterparts. We will continue to adjust hours among our stores to maximize the overall level of service provided.

Access to DeCA Sales Data

ISSUE: DeCA makes its product movement data available to the public through one contractor on an exclusive basis. In exchange, DeCA receives a royalty on the resale of its data as well as product movement reports. Manufacturers and others dependent upon DeCA sales data cannot obtain it directly from the government nor other vendors. The standard practice by commercial retailers is to make their product movement data available to multiple parties, providing choices to manufacturers and other purchasers of such information. The current contract governing DeCA's arrangement expires December 1995.

QUESTION: Does DeCA plan to follow industry practices and make its product movement data available to more than one party? If not, what is the benefit to taxpayers and Commissary customers.

General Beale: DeCA is primarily seeking Category Management Support Services with the current solicitation. These expert services will greatly assist DeCA in making the proper mix of products available to its patrons. This product mix is critical to satisfying customer demand and ensuring patron savings. The value of the contract is primarily the consultant services DeCA will receive in exchange for its raw product movement data. While the contract will not prohibit sales to others, we believe limiting the award to only one contractor is necessary to ensure DeCA gets this valuable service.

Competitive Analysis

ISSUE: Commissaries and Exchanges seem to be challenged by the drawing power of such major retail outlets as Wal-Mart, K-Mart, Sam's Club; as well as the countless major grocery chains who compete in the locations where active military installations exist. The buying power, promotional activities and general excitement these outlets provide to all customers, including military consumers, is frequently cited as a concern.

QUESTION: What information does DeCA, AAFES and NEXCOM receive on those major grocery, discount and warehouse club outlets with whom they compete. Is there consistent monitoring of these stores' performance against the military stores and how is this information used to ensure customer needs are being met?

General Beale: DeCA receives information and data in various grocery, discount, and warehouse outlets from the grocery industry and trade publications. The Category Management Support Services contract will provide information on which to compare category performance of commissaries with the retail marketplace.

Periodically, DeCA conducts a market basket comparison to measure the value delivered to its patrons and analyze its sales effort throughout the entire commissary system. The approach is to randomly compare a stratified sample of its commissaries with local stores.

General Beale. The Defense Commissary does not gather statistics which reflect the status of the patrons utilizing its facilities. Patrons entering commissaries are asked to present military identification in order to gain admission to the store; however, counts are not maintained as to the numbers of each category of patron entering the store. DeCA has no records which would enable it to provide a response to this question.



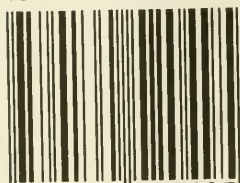
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Mr. MCHUGH. With that, the meeting stands adjourned.
[Whereupon, at 12:50 p.m., the hearing adjourned.]



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